

FOREIGN DIRECT INVESTMENT IN HYDROPOWER: CHALLENGES OF  
ECONOMIC DIPLOMACY IN NEPAL

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## LETTER OF RECOMMENDATION

I certify that this dissertation entitled "Foreign Direct Investment in Hydropower; Challenges of Economic Diplomacy in Nepal" was prepared by Mr. MahendraGautam under my supervision. I hereby recommend this dissertation for final examination by the Research Committee Master's in International Relations and Diplomacy, Tribhuvan University, in fulfillment of the requirements for the degree of MASTER'S IN INTERNATIONAL RELATIONS AND DIPLOMACY.

.....

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## **APPROVAL LETTER**

## **DECLARAION**

I hereby declare that this dissertation is my own work and that it contains no materials previously published. I have not used its materials for the award of any kind and any other degree. Where other authors' sources of information have been used, they have been acknowledged.

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## **ABSTRACT**

Nepal has enormous prospect in hydropower development. Despite this fact, Nepal is facing energy crisis since decade. The major problem in this area is a lack of investment for hydropower generation. Foreign Direct Investment (FDI) is one of the options to generate investment for hydropower development of Nepal. Foreign relations and diplomacy is major tool to negotiating FDI and investment in their country. There are several challenges in the field of economic diplomacy, especially in the field of FDI generation to develop hydropower. Considering the fact this research is focused on the challenges of economic diplomacy of Nepal especially in the field of FDI generation of hydropower. The study is focused on library research, research articles, reports of different researchers, records of the draft or the reliable information of the past and present agreements between the Investors and Nepal Government, different policies and acts regarding and related to foreign investment, case study of ongoing and completed hydropower projects etc. are research variables. Research came with the conclusion that there are five major challenges of economic diplomacy in generating FDI in Hydropower. First is Policy Level Challenges that includes the issues like land ownership, labor management, taxation, currency exchange, one window policy. Second is Geopolitical Conditioning that includes physical geography, passible trading areas and immediate bordering countries related complications. Third challenge is Cost, Human Resources and Physical Infrastructures for energy trade and development. Fourth Challenge is Diplomatic Negotiation which includes diplomatic knowledge, authority and accountability. Finally, political instability and security is another challenge of economic diplomacy in FDI generation.

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## LIST OF ABBREVIATION

ADB	Asian Development Bank
BIMSTEC	Bay of Bengal Initiative for Multi- Sectorial Technical and Economic Cooperation.
BIPPA	Bilateral Investment Promotion and Protection Agreement
BOOT	Build Operate Own and Transfer
EA	Electricity Authority
FDI	Foreign Direct Investment
FITTA	Foreign Investment and Technology Transfer Act
FY	Fiscal Year
HDP	Hydropower Development Policy
IBRD	International Bank for Reconstruction and Development
IMF	International Monetary Fund
IPP	Independent Power Producers
MNC	Multi National Company
MOFA	Ministry of Foreign Affairs
MW	Mega Watt
NEA	Nepal Electricity Authority
NEC	Nepal Electricity Corporation
NEF	Nepal Energy Forum
NGO	Non-Government Office
NIB	Nepal Investment Board
NPC	National Planning Commission
NRB	Nepal Rastra Bank
NRN	Non- Resident Nepali
SAARC	South Asian Association for Regional Cooperation
TA	Technical Assistance
THT	The Himalayan Times
USA	United States of America
USD	United State Dollar
USSR	United States of Soviet Russia
UK	United Kingdom
WB	World Bank

# CHAPTER-1

## INTRODUCTION

### 1.1 General Introduction

Foreign policy refers to the policy of any sovereign state to interact with different states and international actors. It is a viewpoint of achieving the national goal, development, security, and public welfare which may or may not be achieved through the diplomatic depth of that country (Bhattarai, 2012). It involves goals, strategies, measures, methods, guidelines, directives, understandings, agreements done by a state with international personalities. These are the means of conducting international relations. Foreign policy is a fundamental goal or the guideline for the fulfillment of national interest. Foreign policies consists of aims and measures that are included to guide government's decision and actions with regard to external affairs, particularly relations with foreign countries (Jackson.&Sorensen, 2014).

Being an independent sovereign nation, Nepal has an independent foreign policy to fulfill the national interests that includes security, peace and economic prosperity. Fundamentally, it is guided by the provision of United Nation Charter, Non-alignment Movement, Principles of *Panchaseela*, International Law and norms and different bilateral and multilateral treaties and agreements in different times (Constitution of the Nepal 2072, Article.51). One of the Nepal's prime national interests is economic prosperity that is included in the directive principles of the nation.

Foreign policy is a dynamic phenomenon. With the change in the socio-political and economic context it changes its priority and nature (Bhattarai, 2012). The foreign policy priority after unification of Nepal was primarily focused on maintaining balanced

and friendly relation between India and China. King Prithivi Narayan Shah's divine preaching on their geopolitical significance as ' Nepal is a Yam between two boulders. Friendly relations should be maintained with both China and India. Do not engage in offence with them. Fighting, if it is must, should only be to defend oneself', is significant even till the day (Gnyawali and Niraula, 2074). Nepal has been trying the same spirit from the history but there was slight imbalance in neutrality as we share open border with India. Cultural proximity, geopolitical constraints guided Nepal to tilt slightly more towards South making the North quite concerned. It is because the foreign policy priority during Rana Regime in Nepal was simply to protect their oligarchy regime that was possible only by influencing and impressing the then British East India Company ruling in India. 'The incident of loot' of Nepali business communities in Tibet helped to ruin the relationship with Northern neighbor that resulted war between the countries and Chinese intervention annoyed Nepal more to tilt towards India. Jung Bahadur's role in 'Sepoy Mutiny' prospered the bilateral tie. The 1923 treaty of Friendship helped Nepal to gain sovereign status that was one of the great achievement and respect to gain for Nepal in world forum. (Bhattra, 2012). Post-colonial era was the period of ideological polarization i.e. Communism and capitalism. The powerful west including the Asian giant India always wanted to stop the influence of communism in Tibet. After independence of India, Nepal helped her to defend from growing influence of communism in Tibet (K.C., 1975). India wanted the equal contribution from Nepal. That is the reason it helped in Nepal's democratic movement in 1950. From Kings Exile to Delhi agreement in each and every step India made Nepal indebted. Nepal's geopolitical situation also compelled Nepal to depend upon almost all the reformations including

political change. The influence started to be seen in Nepal as King of Nepal kept an Indian national as an adviser of him (K.C., 1975). Today the main guidelines of Indo-Nepal relation have been the Indo-Nepal Peace and Friendship Treaty of 1950. According to the provision of that treaty neither government shall tolerate any threat of security of other by a foreign aggressor. This treaty kept Nepal close to India and created distance in China-Nepal relation. Since the treaty was signed India has been providing economic, trade and technological health and education sector development assistance to Nepal in huge amount and even transit facility through India to be linked to the outer world (Ghosh, 2015). Nepal-India relation grew with no pitfalls during different political and social movements in Nepal - like introduction of 'Panchayat', restoration of democracy to people's movement II. There were ups and downs in bilateral relation but those were solved with equal efficiency. The base of all the relations is cultural and geographical proximity (Bhattarai, 2012). After getting membership in United Nations Organization Nepal got access to the international community. Nepal maintains diplomatic and economic relationship with many countries in the world. At present, Nepal has developed bilateral relation with 168 countries. Membership in different regional forums like South Asian Association for Regional Cooperation (SAARC), Bay of Bengal Initiative for Multi-Sectorial Technical and Economic Cooperation (BIMSTEC), Nonaligned movement and Group of Land Locked countries, which Nepal chaired for long provided huge platform with valued presence in international arena. Introduction of Republic in Nepal, foreign policy priority has completely shifted towards broader vision. India centered policy became the policy of equidistance with both the neighbors in many fields despite having cultural proximity towards the south

(Hamal, 2010). However, Nepal is not been able to attract the capital from both the neighbors, considered market of Nepal's hydro-energy, in hydropower generation.

China is rapidly developing country in the modern world. The technological development of China backed up by its growing economic prosperity is alluring Nepal at its best. Geopolitically, there are some topographic constrains to promote economic interest from the side of Nepal. However Nepal is eyeing the possible avenue to meet the world market through Chinese territory. The impact has started to be seen as Nepal has signed agreement with China for access to the sea and also signed the agreement on Belt and Road Initiatives that launched by China to link the outer world. BRI not only helps to get attached with China in trade and economic relation it also helps Nepal to extend its reach to the world (The Himalayan Times, 23April, 2018).This transition of Nepalese foreign policy has brought new hope with new priority that is economic prosperity in the days to come though there left a lots to think how to present fruitful existence in international forum. Diplomatic negotiation can play huge role in fulfilling national interest includes the economic prosperity through hydropower development.

Diplomacy is an art of conducting foreign relations with other countries. It is practiced utilizing varieties of tools, means, to achieve the national interest. It is defined in relation to political system, geographic structure, economic status and resource availability. In fact, it is an art designed to fulfill the national interest of a nation. Diplomacy is taken as well resourced, tactful act to generate the power of an independent state. This is the prime weapon to fulfill the national interest of a country which is the main objective of foreign policy. That means diplomacy is an essentially a political activity and, well resourced and skillful, a major ingredient of power.(Bridge, 2010,pp.1).

Similarly, Economic diplomacy adds economic interest in diplomacy. It mainly focuses on international trade, tourism diplomacy, economic cooperation, foreign direct investment and many more. It is a strategy of realizing and promoting the country's economic interest by using our diplomatic skills in international arena. It promotes active involvement in international financial institutions and markets. It is not a completely new concept rather bear long history but economic diplomacy came into spectrum after Breton wood conference in 1944 (Jackson and Sorensen, 2014, p.181).

At present, achieving Foreign Direct Investment (FDI) has become the successful means of economic diplomacy that is used in infrastructure development in the underdeveloped, developing and developed countries in the world. In the past the means of diplomacy tend to rely on the utilization of military force or coercive diplomacy. Many states used it by means of extension of empires and forming the colonies. After the end of colonial power, especially after world war 2<sup>nd</sup> two adversarial nations practiced economic diplomacy by not using military power or the coercive diplomacy rather implemented the art of persuasion. USA, Germany, France, Britain in the past and even China used the same means of persuasion in their economic diplomacy (Davis, 1999, pp.3-4). This is the sign of changing dynamics of economic diplomacy in modern world.

The concept of Foreign Aid emerged during the decade of 1940s. Devastation of World War II ruined the economy of almost all the war-torn countries in the world. In 1944 Bretton Woods's conference created the International Bank for Reconstruction and Development (IBRD) and International Monetary Fund (IMF). Those institutions started to provide soft loan to rebuild war-torn countries and underdeveloped countries in Latin America and Africa. United States of America introduced 'Marshall Plan' as concessional

loan amounting USD 13.3 billion to 16 countries in Europe under economic recovery program (Bhattarai, 2012). After that economic liberal policy, United States of America got better access to foreign markets of Europe. The critiques of that the main goal of that step of economic cooperation had two hidden interests over reconstruction: stopping the influence and spread of communism and security as United States provided aid to Japan realizing the geopolitical significance of it (Bhattarai, 2012).

Foreign Aid is almost down sized by Foreign Investment during the decade of 1990s and it was institutionalized firmly after the establishment of World Trade Organization (WTO) in 1995 (Jackson and Sorensen, 2014). After trade liberalization, thousands of Multinational Corporations (MNC) were established. Those MNCs started to expand their business around the world with numerous subsidies conduct business. They started their search for investment opportunity all around the world. They invested in huge amount in world market with full or partial control on market activities (Gilpin, 2001). The result, the world has become a global village in the field of trade and investment by different countries, MNCs and foreign nationals.

Foreign Direct Investment is defined as a cross border investment through foreign companies and the countries in host country. It is simply a transfer of funds or material from one country to another in return of earning. Generally, foreign investment is considered as investment by foreign nationals, foreign corporate bodies, foreign government, and international institutions (Bhattarai, 2012). At present FDI has been one of the successful means of economic diplomacy that is used in infrastructure development in the underdeveloped, developing and developed countries in the world Although FDI has grown rapidly in developing countries, most FDI has been placed in the United States



and Europe and the rate is also growing in underdeveloped countries (Gilpin, 2001). In this context, FDI can be taken as tool of multinational cooperation for the development of infrastructures in economically poor countries as well as the investment opportunity for the countries with higher economic growth and the multinational companies with investment capacity to expand their trade and economic influence. FDI has increased trade opportunity immensely. That is the reason the growth rate of FDI in present world is at a rapid pace. Between 1985 and 1990, FDI grew up with an average of 30 percent a year, an amount four times the growth of world output and the three times the growth rate of trade (Gilpin, 2001).

Foreign Direct Investment attracts the investment from outside. It only when comes when there is competent economic diplomacy based on the national interests. Economic diplomacy, especially, FDI generation comes under the jurisdiction of central government. However FDI can be generated by private sectors dealing with the Multi-National Corporations, Investment Companies and even individuals that can be foreign nationals. General understanding of FDI is simply the transfer of the capital but it covers broad areas. It can be investment in share (equity), establishment of the branch of already established company, technological transfer and management control over the company of host country, lease contract etc. (Technology Transfer Act, 1992). This definition covers mainly two types of investment policy: Foreign Direct Investment, Portfolio Investment. It is the movement of capital across the national frontiers in a manner that accepts the investors' control over the acquired assets. Portfolio investment is obtaining or purchasing stocks, bonds or other financial instruments not involving the management of assets, transaction that requires international transfer of funds (Bhattarai, 2012).

Investment can be promoted either in the form of economic investment or in the form of technological transfer. Foreign investment can be made by foreign nationals, foreign corporate bodies, foreign government, and international institutions differing from donation, grantor budgetary assistance to the government of host country by any foreign government, international institution of foreign nationals. It can be provided to private sectors or to the government. Different modes are in practice through which a foreign investor undertakes the production process in the host country. There are different strategies of investment; one is Greenfield Investment, a process of setting a plant or an affiliation in the host country for the production of goods using local materials. Second, Merger or an Acquisition of a company or a local firm in the host country. And third, working in joint venture at local. In Greenfield Investment, a parent company starts a new venture in a foreign country by constructing new operational facilities and acquiring new fixed assets. In cross-border mergers, the assets and operations of two firms from different countries are brought together to establish a new firm with complete legal authority. In the process stocks of both companies are surrendered and stocks get issued unitarily. The control of assets and operations is transferred from a local to a foreign company. The target company legally ceases to exist, the buyer takes over the business and the buyer's stock continue trading (Chaudhuri&Mukhopdhyay, 2014). Since 1990s, merger and acquisition process got huge popularity leading enormous amount of FDI flow in developing countries. That is a paradigm shift in the field of FDI generation. In recent time, the share of cross-border merger and acquisition in FDI has increased in industrial countries as well (Chaudhuri and Mukhopdhyay, 2014).

Nepal has huge resource of availability of water with possibility of development of hydropower. Economically viable capacity of hydropower generation is more than 40000 megawatt in Nepal (USAID, 2018). However, the country has been going through the extreme deficit of energy in recent years. Investment in hydropower production is completely nominal. The present rate of investment cannot assure the energy security in the country. FDI is only weapon to develop hydropower production (Thapa, 2011). To attract foreign investment in country, Nepal has signed the Bilateral Investment Promotion and Protection Agreement (BIPPA) with more than five countries (Ministry of Industry, Commerce and Supply, 2020). Foreign investment in hydropower development of Nepal is negligible and FDI in hydropower generation has not been achieved as expected. The reasons behind the problem might be in policy, ineffective diplomatic practices, political instability, wide spread corruption and internal security concern. Beyond that Nepal's geopolitical situation could be another prominent factor to foster difficulty. If the policies are made considering those factors, problems regarding the FDI generation might be resolved and there seems great prospect in hydropower development and energy export to its neighboring countries including India, China and the SAARC member countries by building cross border transmission lines.

The Constitution of Nepal (2015) has outlined the directive principles, policies and obligations of the State regarding its foreign policy. The major principle of foreign policy of Nepal is guided by the abiding faith in the United Nations and policy of non-alignment, mutual respect for each other's territorial integrity and sovereignty, non-interference in each other's internal affairs, respect for mutual equality, non-aggression

and the peaceful settlement of disputes, and cooperation for mutual benefit as per the guiding principles of our foreign policy (Constitutions of Nepal, 2015).

First time in history, Nepal established diplomatic tie with Britain in 1816. Similarly, Nepal established a diplomatic relation with India and China respectively in 13th June, 1947 and 1st August 1955 (Hamal, 2010), but its relation with both of them goes back to the centuries back especially since their existence. Nepal's foreign relations with China and India have evolved through different events, stages and periods in history. So, Nepal has multitude level of relations with these two neighboring nations- ranging from social, cultural, religious, geo-political, and economic to diplomatic relations. These relations have grown through different ups and downs, and transformed from simple, linear relation to complex, weird relations. At present, Nepal has established diplomatic relations with 168 nations (MOFA, 2019). After the declaration of new constitution in 2015 and establishment of federalism in Nepal, Nepal's relation with China and India needs to be redefined and revised in the changed perspective and is sure to evolve from new dimension (Bhattarai, 2012). Within framework of broader foreign policy framework, diplomacy as a tool plays vital role to keep vibrant relation with other countries. Diplomacy plays very important role to achieve national interest of a country. It is a means to form, develop and maintain relationship between the countries. Every state uses numerous tools, means to achieve the national interests depending upon number of factors like geopolitical sensitivity, political strength, resource availability, economic, military and cultural situation and so one. One of such tool is diplomacy (Bhattarai, 2012). So, diplomacy bears huge signification in FDI generation, as it can be

the means to achieve goal of capital generation for investment in industry and infrastructures in a country.

Nepal's economic diplomacy was gaining momentum after the restoration of democracy. Country became able to drag the attention of some of the valid investors in the world. Bhotekoshi and Khimti are the major success in economic diplomacy of Nepal. That experience reflected the promising future for FDI in Nepal. However, the political instability prevailed from 1996 to 2075 shattered the enthusiasm of Nepalese economic diplomacy. It brought huge cost in the inflow of foreign investment. The energy summits of 2060s in the beginning shown some hope but later half of the decade again came with more hopelessness than the positivity (Thapa, 2068). The Investment summits held in 2017 with about 250 international investors promising to invest about NRS. 13.74 billion (Government of Nepal, Office of the Investment Board, date 29 march) and 2019 brought back some hope with 15 deals and memorandum of Understanding and more than 1300 participants from different countries in the world ( The Kathmandu Post,31 march 2019.) Non-Residential Nepali (NRN) have also shown interest. Mai Khola (20 MW) will be built through local investment and funding provided by Non-Residential Nepali. NRN- London has promised to invest in energy sector collaborating with Api Power Company for the generation of hydroelectricity. Over all, some brighter prospects are seen in FDI generation in recent years. But investment summits could not get expected investment commitment in hydropower sectors though the environment of security and political stability are in the favor of investors at present. That shows security and political stability are not only the major challenge in hydropower

development, there might be other factors like geopolitical situation, diplomatic negotiations and many others which might not have studied properly yet.

Recently, Millennium Challenge Corporation deal is under the discussion and debate that was proposed by USA for the hydropower and roadways development in the country. Some of the provisions like conscience of India is must for the development activities of Nepal is issue of debate that shows geopolitical constrain in economic diplomacy (The Kathmandu Post, 31 March 2019). So, geopolitical aspect is also needed to study to find out the real reason why FDI flow is not as expected in hydropower sector.

At present Foreign Direct Investment has become the successful means of economic diplomacy that is used in infrastructure development in the underdeveloped, developing and developed countries in the world but in the context of Nepal FDI generation especially in hydropower sector is very less in comparison to the other parts of the world. The reason behind it can be because of some weakness in diplomatic endeavors especially the on negotiation. This aspect also is in need of some more research.

## **1.2 Hydropower Development in Nepal**

USAID (2020) claims that Nepal has potential of 40000 MW electricity generation and also economically viable in Nepal (USAID, 2020). National Planning Commission report published in 1985 confirms that the total power that can be generated is about 43,000 MW (Adhikari, 2006). These facts though not stated unanimously, make clear that hydropower generation one of major source of Nepal's economic prospect in the days to come. Hydropower is simply the best means of economic prosperity because it is the only sustainable and low cost energy availability.

Nepal has very long history of hydropower generation. The first hydropower plant was established at Pharping (500-KW) in 1911. It was established during the regime of Rana ruler Chandra Shamsher Jung Bahadur Rana. At that time it was aimed to meet the energy requirements of only to the members of the ruling class, especially the royal family and their relatives. Despite this fact, it could be taken positively that rulers took very first step to generate hydroelectricity. His Late Majesty King Prithivi Bir Bikram Shah Deva inaugurated the plant on May 1911 (Adhikari, 2006). After the establishment of the first hydropower plant at Pharping in 1911, the second hydropower plant with the capacity of 640 Kilowatt was established at Sundarjal in 1936. Similarly, Morang Hydropower Company was established in 1939, built 677 KW Sikarbas Hydro plant at Chisang Khola in 1942. After the introduction of planned development process in Nepal hydropower came to the most prioritized sector in almost all the succeeding development plans. The First Five-year Plan (1956-61) aimed to add 20 MW hydropower. However, the government could not meet the target. That was the situation in later years though people hoped rapid development progress after the political change occurred in the

nation. In 1962, Nepal Electricity Corporation (NEC) was established and was given the autonomous responsibility of transmission and distribution of the electricity. The Electricity Department was responsible for the task of electricity generation. After a long gap with the construction of the Panauti Hydro power plant (2400 KW) in 1965 and the Trishuli Hydropower plant (21000 KW) in 1967 brought some hope in the field of generation of energy in Nepal (Thapa, 2011). After that numerous hydropower projects were launched. Government of Nepal established the Eastern Electricity Corporation under Nepal Electricity Corporation In 1977, Small Hydropower Development Board was also established. Government realized the policy for the investment in hydropower as a result Electricity Corporation Act 2041 was introduced in the same year and came into effect from 2042 B.S. It helped in institutional restructuring in energy sectors that led to the merger of Electricity Department, Nepal Electricity Corporation and all the Development Boards resulted in the creation of Nepal Electricity Authority (NEA) (Thapa, 2011). Since then NEA has been given all the responsibilities for the generation, transmission and distribution of electricity. But in the case of investment did NEA get authority to deal with international Investors? Overlapping responsibility and authority could cause the lack of FDI generation that is not researched properly.

Many private and public sectors paid interest for investment in hydropower sector. Public sector institutions involved in the hydropower sector include Water and Energy Commission and its Secretariat constituted in 1976, the policymaking body established in 1981, and the Department of Electricity Development. In 1992 Private sector also emerged as an important player in the hydropower development. Independent Power Producers (IPPs) have been the ongoing institutional innovations in the power



sector of Nepal, with the IPPs signing power purchase agreements (PPA) with the NEA to sell electricity (Adhikari, 2006). This seems that during the decade of 70s and 80s hydropower generation got huge hype in the country, however the result was not convincing.

Government of Nepal realized the need of capital generation for hydropower promotion in 1990s. That period was the period of economic liberalization, Nepal introduced new policy and Act. The 'Foreign Investment and Technology Transfer Act 1992' formulated to attract the foreign investment in development and production sector which was taken as one very significantly positive step towards energy development. The Company Act 2006 opened the multiple avenues to invest in Nepal, which allowed the private sectors, Public-Private partnership, Multinational corporations and foreign government to invest in Nepal (Bhattarai, 2012). The result is seen hydropower sector. Kulekhani I, (60MW), Marsangdi (69MW), Middle Marsangdi (70MW), and Kaligandaki (144MW) are the example of FDI in Nepal. Similarly International Private Sector investment and International Commercial Bank invested in Khimti (60MW), Bhotekoshi (36MW) and many other power projects. Nepali private sectors also put hands together in the energy development. Under the public private partnership about one dozen hydropower projects were constructed; Chilime (22MW), Piluwa (3MW) are few example of it. After the huge decade-long conflict, Finally India has got opportunity to build Arun III hydropower project with capacity of 900 Megawatt. At present numerous hydropower projects are under construction. Until 2018 Nepal has been able to generate about 1100MW of hydroelectricity and NEA claims that 750 MW energy will be added till the end of 2019 as mega project like upper Tamakoshi will be completed by the end of 2019

(The Kathmandu Post, August 17, 2018). However, the rate of FDI flow in hydropower generation is very low than the It could have been. Nepal has not become completely self-dependent in energy until now. Energy trade is still far from its reach.

Hydropower development has been a huge prospect for Nepali economy. Foreign investors are eyeing very keenly to invest in this country for a long time. After the establishment of Pharping Hydropower project in 1911, with British assistance, Nepal has opened the avenues to interested investors to unleash what most of the entrepreneurs believe could be an extremely profitable investment in Nepal. Different countries have invested here in the field of hydropower. Foreign investment in Nepal is categorized in three different groups according to the nature of it.

Table 1. Hydropower Projects Constructed Through Grants (Direct Investment)

<b>Name of Project</b>	<b>Capacity</b>	<b>Investors</b>
Pardi	1 MW	India
Trishuli	21 MW	India
Devighat	14.1 MW	India
Sunkoshi	10.5 MW	China
Seti	1.5MW	China
Panauti	2.4 MW	Former USSR

(Dhungel, March, 2016, p.22)

Table 2. Hydropower Project Constructed Through Loans

<b>Name of Project</b>	<b>Capacity</b>	<b>Investors</b>
Kulekhani	92 MW	WB, Japan, Kuwait
Marshyangdi	69MW	Germany
Kaligandaki A	144MW	ADB, JICA, WB
Middle Marshyangdi	70MW	Germany
Upper Trishuli 3A (Under construction)	60MW	China
Upper Marshyangdi (Under construction)	50MW	China
Chameliya (Under construction)	30MW	Korea

(Dhungel, March 2016, p.22)

Table 3. Hydropower Project Constructed Through FDI

<b>Name of Project</b>	<b>Capacity</b>	<b>Investors</b>
BhoteKoshi	45MW	USA
Khimti	60MW	Norway

Upper Karnali (to be started)	900MW	India
Arun III (to be started)	900MW	India
West Seti	750MW	China (Not started yet)

(Dhungel, March 2016, p.22)

India, China, and the former Soviet Unions have been providing assistance in Nepal for the development of hydropower projects. All of those countries have very special relationship with Nepal. India and China are not only the immediate neighbors of Nepal but also the potential market for the energy produced in the country. Soviet Union invested in Nepali hydropower during the Cold War strategically and recent time not investing as expected but diplomatic efforts can be made to drag that country for more investment in the days to come. In terms of bilateral assistance, grant is the most common form of investment until 1970s. After that more loans and fewer grants are in seen the poor country like Nepal. At the end of the 1970s nature of investment changed from bilateral assistance to multilateral investment (Dhungel, 2016).

After the 1970s, the trend of investment in other countries completely changed. Rather than grants bilateral and multilateral investment started to come through loan. The main sources of loan were mainly from International Finance Institutions (IFIs) such as the World Bank (WB) and Asian Development Bank (ADB). The countries like Japan, Kuwait, Germany, China and Korea also collaborated with different institutions to invest in Nepal's hydropower projects such as Kulekhani I and II (60 MW and 32 MW), Kaligandaki 'A' (144 MW), Marsyandi (69 MW), and Middle Marsyandi (70 MW) of Nepal (Hydro Nepal. January 2016).

During 1990s Nepal experienced the political change. Expectation for foreign cooperation was huge as democratic movement got success in the country. Nepal did not get foreign investment as per the expectation in the investment. The period of 1980s and

90s was the period of revisit of investment policy by Bretton Wood Institutions. They developed new policy named 'Structural Adjustment Program'. That changed the modality of financing or investing in hydropower sector. That new program forced some economic reforms in recipient country. In fact, the provisions introduced more conditional funding as an influence to domestic economy (Hydro Nepal, January 2016). FDI also attracted to some of the Indian companies like; GMR (India) and Sutlaj (India) and non-Asian private companies such as Stat Kraft (Norway) to provide the necessary funding for larger hydro projects. Collaborating with International Financial Institutions, the US invested in Bhotekosi (45 MW), and Norway also financed in Khimti (60 MW). The trend continued in Upper Karnali, Arun III and West Seti got to construct by private foreign investment from India and China respectively (Hydro Nepal, January 2016). But the case of West Seti is getting complex as China after holding the project for six year decided to step back. The reason given by China was due to the high rehabilitation cost, transmission lines, humanitarian reason and environmental issue (Ghimire, 2018), but there needs a proper research on the issue as the only reasons put forward by China cannot be the sole reasons for its withdrawal. And most importantly the obstacles can be the common problems of FDI generation in hydropower sector as a whole.

### **1.3 FDI Policy of Nepal**

Foreign Direct Investment (FDI) has been one of the major contributing factors in most of the developing countries and even in developed countries in the world. It has contributed heavily in countries economy since the decades of 1980s. It has become the part of globalization in modern world. Nepal has been working in the field of FDI

generation since 1950. However the amount of FDI has not received as in its neighboring countries. Until 2018, foreign investors from 39 countries have made investment in 252 firms in Nepal. (NRB, 2018). The policy level attempt to generate FDI started in 1981. During the decade of 1980s government of Nepal started legal reform with the aim to bring foreign capital, technology and management skill in government and private sectors. Private sectors were also integrated in the investment policy. In 1991 government of Nepal took huge step to attract foreign investment by drafting One Window Policy that helped to get government commitment for transparent investment and utilization of FDI. In the following year Foreign Investment and Technology Transfer Act 1992 was launched. However, the result in the field was not as expected as it could be. In order to ease the constraints Government brought New Industrial Policy 2010 with some timely change in the provisions to make sure that industrial policy of Nepal is completely favorable to the foreign investors to invest in Nepal. New policy also guided Nepal to get WTO membership and membership of other regional trade Organizations like BIMSTEC, SAFTA were taken. It made easy for foreign investors to get markets for their products (Foreign Investment Policy, 2071, P.1).

Since the decade of 2060s Nepal government brought new act to bring back the capital of NRN in Nepalese infrastructure development. Government opened the avenue for NRN to invest in Nepal as common Nepal citizen with special facility and recognition like foreign investment (Investment Board Act, 2068). Non Residential Nepali Act 2064 also eased NRN to invest in Nepal (NRN Act, 2064). Foreign Company or Investors can register foreign company under the act to perform business in specified fields in Nepal. They can perform activities under the law (Company Act 2006). This is highly

encouraging for foreign investors. Constitution of Nepal 2072 also encourages FDI generation as economic and infrastructure development is one of the prime national interest of Nepal. Encouraging and mobilizing of foreign capital and technology for the development of infrastructure in the areas of export government is always favoring FDI in Nepal (Constitution of Nepal, 2072, Part-4, Article 50/10). Government of Nepal has also made easy and effective to invest in Nepal by any foreign investor as there is straight forward process of approval. Approval will be provided with in the seven days of application. The approving authorities are shortened as only Department of Industry and Nepal Investment Board have given responsibility. NRB's approval also needed after those two which is almost like ceremony though NRB reserves the right not to approve. Approval process is simply the fast track as Prime Minister chairs the Investment Board. Visa processing is also made quite easy for the people to invest and their family if investors are individual. Two members of the family can get visa under this provision. For the skilled human resources non-working visa will be granted (Foreign Investment Act, 2019). All these provision seem quite encouraging and favorable to generate FDI in Nepal which has been changed time and again to make effective and easily accessible for the foreign investors. However, policy needs to revise time and again to meet the challenges emerging while working in the field.

#### **1.4 Statement of Problem**

Nepal is rich in water resources. The very big irony is that the crisis of energy in the country despite having enormous water resources. People have been suffering from energy crisis in their daily life. However, energy trade is taken as one of the major means to get economic prosperity in the country. Due to lack of capacity to invest in

hydropower sector, the goal is far from the reach. Nepal has been striving to get foreign investment in the field but level of success is very low. Economic liberalization of post-1990s also could not impact more in the field of hydropower development. The Foreign Investment and Technology Transfer Act 1992 (FITTA) formally opened the door for Foreign Direct Investment (FDI) in the country. Later on with every political change new reformed policies have been made to attract foreign investment in the country. Foreign Investment and Technology Transfer Act 2075 has brought some changes to ease to foreign investors. Still the volume of foreign investment is very low compared to its expectation. Recent Investment Summits in the decade of 2010 also could not get expected outcome. Due to which, having enormous prospect in hydropower generation Nepal is still facing energy crisis, the export of energy is yet the dream of country. The immediate neighbors are in rapid pace of economic development. They need huge amount of energy. Theoretically, Nepal can export energy to both the countries. The problem lies in the generation of economic resources for hydropower production. FITTA ensures the prospect of FDI still the expectation is not met. The major water sharing agreements between India and Nepal in the past suffered due to the lack of proper preparation and negotiation for investment, connectivity and hydropower production. What Nepal achieved in those agreements is not worth to mention rather it lost the way to suffer for hundred years. Nepal's immediate neighbors China, India and even Bangladesh are in dire need of energy to keep going industrialization. Nepal needs appropriate policy and environment to attract FDI in hydropower development. In this context, it was necessary to analyze the challenges of economic diplomacy of Nepal especially in the field of FDI generation in hydropower.

## **1.5 Objectives**

The objectives of this research are:

1. To analyze the major constraints of hydropower development in Nepal
2. To analyze the challenges of economic diplomacy in Nepal, especially in relation to generation and implementation of FDI in hydropower.
3. To find out the complexities of economic diplomacy in Nepal's geopolitical context.

## **1.6 Research Questions**

1. What is the status of hydropower generation in Nepal?
2. What are the problems regarding hydropower development in Nepal especially in diplomatic negotiation with international communities in FDI generation?
3. How economic diplomacy can be tool to overcome the constraints of FDI generation in Nepal in present geo-political context?

## **1.7 Significance of Study**

Nepal has enormous natural resources. It is one the richest country in the world in water resources (Thapa 2011). However, it has been facing huge energy problem.

Country is purchasing energy from India. Nepal's immediate neighbor India is rapidly industrializing country with potential market for energy export as it needs of almost 17,000 megawatt electricity annually (Thapa, 2068). Like India, Nepal can export energy to other South Asian countries. There is already power trading between India and Nepal. India and other South Asian countries including Bhutan, Sri Lanka, Afghanistan and Pakistan is also interested in energy trading (Gangol, 2014). Bangladesh has also signed



an agreement to purchase energy from Nepal (The Rising Nepal, 2019, December, 21). In this situation energy trade can be the source of income generation for Nepal.

As Nepal bears huge potential in energy trade with enormous possibility of hydropower generation, this research can be helpful to erase the major problems related to investment generation in hydropower sector by addressing the challenges of economic diplomacy of the nation. The research objective is to find the complexities and challenges of economic diplomacy in the field of FDI generation in hydropower sector which can be beneficial in foreign policy making of the country especially in the field of economic policy formulation of the country.

### **1.8 Definition of Key Terms**

Bilateral Agreement- Agreement between Two Government/Party/agent/Agency.

Diplomatic Negotiation- Dialogue between diplomatic representatives of different country.

Economic Diplomacy- It is strategy of realizing and promoting the country's economic interest by using diplomatic skills.

Energy Trade- Trading of hydropower from one country to another.

Foreign Direct Investment- It means transfer of funds or material from one country to another in return of earning.

Foreign Policy- Foreign policy refers to the policy of any sovereign state to interact with different states and international actors.

Geopolitics- It is a global geographical structuring, a location, land structure, bordering of a land which bears geographical, economic, social, cultural and political significance.

## **1.9 Organization of Thesis**

This research will contain mainly seven chapters;

Chapter 1: Introduction, It includes title, statement of problem, objectives, research questions, hypothesis, and significance of research and definition of key terms.

Chapter 2: Literature review, It studies especially hydropower Development in Nepal, Foreign Direct Investment, conceptual understanding of foreign policy, Foreign Direct Investment etc.

Chapter 3: Conceptual Framework/ Methodology, an outline how research is conducted, the sources of data and method of data analysis.

Chapter 4: This chapter talks briefly about Hydropower status of Nepal that is built under FDI.

Chapter 5: This chapter deals about FDI in Nepal in General.

Chapter 6: This chapter covers the discussions of challenges of economic diplomacy in Nepal especially FDI in hydropower.

Chapter 7: Summary and Conclusion

## **CHAPTER 2**

### **LITERATURE REVIEW**

Energy situation in Nepal is extremely poor (CBS, 2012) and country is one of the least developed in the world. To come out of poverty energy needed in coming years must be met through its huge indigenous hydropower potential. Planning hydropower demands expertise and exercise. The benefits and impacts of hydropower schemes are manifold. Unfortunately hydropower development in Nepal till recent past followed on ad hoc basis and dominated by donors (Pun, 2008).

Excellent social impacts like road access, safety enhanced, business and enterprises developed and similar others are already observed in many parts of country due to hydropower projects. Communities are strongly participating and demanding for more. Small schemes developed by Nepalese could manage funding and involve local communities effectively. In addition to external funding and technical assistances, available in-country funding (NRB, 2013) and friendly policy on hydropower could support substantive scale of power generation. In present context, Nepalese technocrats are many in numbers, at least to handle many medium and even big schemes. Environmental issues are important to assure sustainability of project specifically large schemes. Sediment (Thapa, et. al. 2005), earthquake (OECD, 2003), climate change (ICIMOD, 2011) are major concern and demand huge investment to manage. Policy and political stability makes a major concern for the investors and developers.

A study finds mixture of storage and run of river projects should be followed immediately to the extent possible. It is time to strengthening public sector as well as combined private and public sector to engage stepwise for the development of long term,

export oriented multipurpose storage type megaprojects (big and large) for future. With successful implementation of 20 MW Chilime Hydropower (Bhattarai,2005) with Nepalese funding and professionals became mile stone in hydropower in Nepal.

Diplomacy in general is an art of conducting relations with other countries (Bhattarai, 2012). It is practiced utilizing varieties of tools, means, to achieve the national interest. It is defined in relation to political system, geographic structure, economic status and resource availability. In fact, it is an art designed to fulfill the national interest of a nation. Diplomacy is taken as well resourced, tactful act to generate power of an independent state. This is the prime weapon to fulfill national interest of a country which is the main objective of foreign policy. That means diplomacy is an essentially a political activity and, well resourced and skillful, a major ingredient of power (Bridge, 2010).

Economic diplomacy adds economic interest in diplomacy. It mainly focuses on international trade, tourism diplomacy, economic cooperation, foreign direct investment and many more. It is a strategy of realizing and promoting the country's economic interest by using our diplomatic skills in international arena. It promotes active involvement in international financial institutions and markets. It is not a completely new concept rather bear long history but economic diplomacy came into spectrum after Breton wood conference in 1944 (Jackson and Sorensen, 2014).

In the past, the means of economic diplomacy tend to rely on the utilization of military force or coercive diplomacy. Many states used it by means of extension of empires and forming the colonies. After the end of colonial power, especially after world war 2<sup>nd</sup> two adversarial nations practiced economic diplomacy by not using military power or the coercive diplomacy rather implemented the art of persuasion. USA,

Germany, France, Britain in the past and even China used the same means of persuasion in their economic diplomacy (Davis, 1999), which is the sign of changing dynamics of economic diplomacy in modern world.

Investment simply refers to an act of using money to purchase assets in the hope that assets will generate income where as foreign investment means the investment made by the investor either an individual, group, company or a nation outside the national economy (Bhattarai, 2012). In this modern globalized world no country is independent in itself in all the means of production and development. So, foreign direct investment is very important to both receiving and investing parties. Nepal is a developing country with the need of huge investment to develop its infrastructures. Hydropower sector is one of the fields needed to get foreign investment (Bhattarai, 2012).

Economic condition of Nepal is not helping the government to invest huge amount in infrastructures development especially in the field of hydropower as hydropower projects need large capital. In the process of implementation of Federal System, the government will face a deficit of at least RS. 200 billion fund that is huge sum to manage from the GDP (THT, March 2018).

Nepal has been facing huge energy deficit for a few decades though recent condition is not so vulgar. Industrialization is increasing day by day. In this context, Nepal itself is a primary market for the international investors as it is expected of the need of about 1800MW electricity until 2000A.D. The cost of one megawatt hydro-electricity production is about hundred and fifteen millions and it's far from the reach of domestic investors to generate ample amount for large scale hydropower projects (Thapa, 2068). Recently, many investors are not intended to invest in Nepal's hydropower sector

showing the reasons like rehabilitation cost, environmental issue, humanitarian issues and market deficit. But the reason behind the weak flow of FDI in hydropower cannot be limited with in this, which is one of the major issue to research on.

FDI always seeks possible market. India and China are the countries to export Nepalese energy product though Bangladesh also has shown keen interest to import energy from Nepal. Nepal's unique mountainous terrain and rich water resources ensure foreign investors a great advantage by virtue of its geopolitical situation where the neighboring countries bare huge potential for energy trade (Gangol, 2014). But practical analysis on geopolitical constraints are still to research on as it can cause huge investment problem in building cross border transmission line to trade energy to its neighboring countries.

India is facing huge shortage of energy and water and China is also no exception. India alone is huge market for energy export with the need of almost 15,000 megawatt electricity annually (Thapa, 2068). Chinese population is expected to reach 1.4 billion by 2040 and India is also speculated to cross the china in term of population by 2030. The problems both the countries facing is definitely growing higher. China and India both are working with high alarm. Both the countries are investing in agriculture and industry in huge amount which demands more water and more energy. The scarcity is growing strongly. India has started river linking project and china river diversification (Nepal Energy Forum, July, 2018). A new scientific study led by the China University of Petroleum in Beijing reaches to the conclusion that China is about to experience a peak in its total oil production in 2018. Without finding an alternative source of energy it is not possible to sustain the economic growth and promote sustainable development (A

Medium Corporation, October, 2017). During the state visit of Prime- Minister of Nepal K.P. Sharma Oli to The People's Republic of China both the nations agreed to build the cross border transmission line for energy trade. Accordingly, Nepal has sent a draft of Memorandum of Understanding (MOU) to the Chinese government for the joint development of the power transmission lines between two countries (Nepal Energy Forum, July 8, 2018). Still the cross border transmission line towards China is in jeopardy. The might be the geopolitical constraint in execution level which is not studied properly and if not so than it comes to the diplomatic negotiation why Nepal is not been able to make China to work as its commitment.

Besides India and China, Nepal can trade energy to entire South Asia.It can play positively in resolving South Asian energy crisis. There has been considerable interest recently in SAARC countries to build a common grid called SAARC grid. The first cross border transmission line between Nepal and India is now under construction. There is already power trading between India and Nepal and India and other SAARC countries including Bhutan, Sri Lanka, Afghanistan and Pakistan is also interested in energy trading (Gangol, 2014). The concept of SAARC Grid, a means of power trade is also not executed yet. The reason might be beyond politics and security that needs further research in the field.

Many nations and International companies are showing their interest to invest. However, their major concern was security threat in country rather than market, rehabilitation cost, environmental issue and humanitarian issue. The main conditions put forward by the foreign investors in Nepal are; peace, security and political stability. Due to the domestic conflict proper environment for investment could not be maintained in

the past. Maoist insurgency became one of the major factors in security threat in Nepal (Friedman, 2009). It was the case before the peace agreement in Nepal but the issues are already resolved, still investment in hydropower sector is very low. There might be other reasons beyond political stability, which is achieved with majority government and security that needs to research further.

Government of Nepal has made progressive policy, as well as structural and procedural, changes to attract foreign investment. Government provides equal treatment to foreign investment companies as to domestic or the government projects. The Investment board Nepal-2011, a high-level government body chaired by Prime Minister Functions as fast track one window agency for the creation of investment friendly environment for the mobilization of foreign investment(Nepal Investment Board, 2018). Despite having those changes FDI generation is not increasing even at present. That shows there must be need of some policy level reform even after.

Hydropower prioritization based on perspectives analysis and ranking is most challenging specifically where limited and even fragmented data are available. Through detail literature reviewed, a list of most appropriate perspectives is listed. Most documents (Dhungel, 2014, BPI, 2009, USAID, 2002) focus on economics and financial sustainability whereas only limited document (Bhattarai, 1997) applies multi criteria in analysis.

Most appropriate hydropower scheme is medium scale of power in present country context. Big schemes stands on second priority, follow behind medium scheme because of funding paucity, country preparedness, and environmental concerns and associated risk. Small scale plants are up to an extent eco-friendly and moderate on



economies of scale but low power contribution in nation's energy demand. Hence it falls behind medium and large scale power plants on priority preference. Though micro scale schemes have many good features but are poor on economies of scale, generation capacity, areal coverage and enterprises development. Hence in overall priority analyzed, it stands on fourth rank. In spite excellent economies of scale, large schemes due to its export oriented feature limits its economic contribution to Nepal. Further full of uncertainties, lack of resources & capacity and very high environmental as well as social risk put this scale of power generation at lowest priority in present country context (Singh and Nachtnebel, 2014).

The efficient conduct of economic diplomacy depends to a large extent, on the deployment of trained manpower and expertise in all diplomatic missions. These missions should be provided with adequate resources to undertake promotional activities. In the day-to-day schedule of the mission, priority needs to be accorded to the task of promoting and strengthening economic ties with the countries to which missions are assigned. It is important to remember that successful diplomacy seeks to bridge differences and widens common ground to realize or achieve shared interests. (United Nations Development Report, 2006)

Nepal's current comparative advantage in international trade lies in its resource-intensive and labor-intensive product areas. More than 95% of manufactured exports are concentrated in these categories (Nepal Trade and Competitiveness study, 2004). Nepal has already shown clear price-margin advantage in at least eleven export products within her areas of comparative advantage (Pyakuryal, 2004).

Bilateral, regional and international co-operation to initiate mega projects for hydropower development in Nepal is a great opportunity. Investment in hydropower is safe and secure, with investment-friendly climate supplemented by appropriate laws, regulations and credit facilities. Moreover, funding arrangement is being explored; detailed design works are underway for the infrastructure and access road to encourage foreign investors to launch hydropower projects in Nepal. Proper harnessing of water resources and developing hydropower will ensure both sustainable high growth and substantial poverty reduction (Pokhrel, 2020).

## **CHAPTER-3**

### **CONCEPTUAL FRAMEWORK**

#### **3.1 Research Design**

This is a qualitative research. It is a library research. The research articles, reports of different researchers, exports' research articles, records of the draft or the reliable information of the past and present agreements between the investors and Nepal government, different policies and acts regarding and related to foreign investment, ongoing and completed hydropower projects etc. are studied to find the problem related to hydropower development especially in FDI generation. It also aims to analyze the diplomatic efforts in the form of negotiation. The geographical conditioning is another issue the research will be focused.

#### **3.2 Research Methodology**

The main area of this research is challenges of economic diplomacy of Nepal especially in relation to FDI in hydropower development. For this, methodology for research is collecting data from primary and secondary resources. So, the research goes on to study and analyze the policies of government regarding FDI generation, investment framework and the policies, diplomatic efforts made by the government and diplomatic mission abroad for hydropower development. This research also analyzes the investment summits organized by the government in different time frame. It includes at least two different project studies under FDI.

#### **3.3 Collection of Data**

The researcher mainly adopts the following methodology in data collection:

- I. Library research

II. Acts and policies with Laws regarding FDI

III. The agreements and conditions put forward by the investors in different projects

IV. Project study

### **3.4 Analysis of Data**

The data collected from above sources are analyzed epistemologically using rational analysis to reach to the conclusion of the research.

### **3.5 Limitation of Research**

Principal Investigator (PI) of the study could not take individual opinions of experts in the form of interview, draft agreements and reports of different commissions in the field of hydropower sectors, which he considers as the major limitation this research.

Field visit in individual project study could not be done due to the lack of resources.

## CHAPTER- 4

### NEPAL AND FOREIGN DIRECT INVESTMENT

Nepal started to gain FDI since 1956. When bilateral aid began coming into Nepal, there has been a constant tension between the donor's interest and of the host. However donors have been playing a huge role in developing infrastructures in industry, agriculture, educational system, health sector and energy sector. Most infrastructures in Nepal have been built with bilateral grants. The industries established by FDI in Nepal utilized its human and natural resources more effectively and efficiently that helped to generate employment opportunity to the local people. With the change time bilateral grants are replaced by multilateral loans and investment. The renowned private corporations from developed countries have invested their capital through these multilateral arrangements. For instance, Surya Nepal, Dabur Nepal, and Standard Charter Bank were all the result of FDI that indicates the era of grants and social welfare investments are being replaced by private interests and profit making motives in investors (Dhungel, 2018).

FDI history of Nepal traces its beginning way back to more than a century before. United States was the first country that helped Nepal for the infrastructure development. Foreign aid entered in Nepal for the first time in 1951 with "point four program" of USA. However Nepal also signed an agreement for technical assistance with United Nations in 1953 and started to receive aid in the form of grants for development of agriculture, transport infrastructure and power generation (Hamal, 2010). The second country to assist Nepal for its development was the immediate neighbor India. India has started its aid to Nepal since 1952. Nepal's participation in the Colombo plan in 1952 also

persuaded the other donors like Japan Canada, Australia, and United Kingdom to join aidin Nepal. Since then Nepal has been getting foreign aids from these countries quite regularly. From the decade of 1990 Nepal gave priority to the economic and infrastructure development, accordingly new plan and policy are being introduced since that period. Since 1990 Nepal made trade regime more liberal and open and initiated economic reform agenda that included liberalizing trade investment, foreign exchange rate, materializing tariff structure and tax system and promoting export (Rimal, et al 2005).In order to systematize FDI Nepal introduced Foreign Investment and Technology Transfer Act 1992. It was the first conscious effort made for the economic development in the country. After the act FDI and technology transfer got avenue to enter in Nepal. In January 1, 1995 world trade organization (WTO) was formally established. The main objectives of the establishment of WTO were to stabilize and strengthen the world economy, provide higher standard of living to the world people in nondiscriminatory basis, employment generation, and expansion of trade and so on. Nepal got WTOs membership in23 April, 2004 and welcomed provision of technology transfer, conceived an opportunity of attracting foreign direct investment for the increase productivity of goods in diverse sectors. Now legally and formally Nepal entered into the regime of economic liberalization. Since then Nepal is always striving to promote industrialization, increase productivity, exploit natural resources ,export raw materials and most importantly attraction of FDI by getting access to the world market (Bhattarai, 2012).

After the restoration of democracy Nepal acutely focused on the development of infrastructure and poverty alleviation. All the periodic plans country made were focused on the economic development. Lack of capital for the investment was always the issue.

FDI for the economic development was prime priority of the government. Country adapted the liberal economic policy which was favorable to drag the foreign investment. The impact was seen in the foreign policy of Nepal. Some changes in foreign policy made to provide access to the foreign investment in the country. In 2002, Nepal formulated foreign policy with objective of maximizing efficiency gain from foreign aid; financing development activities; and giving clear position, purpose and principles to the potential donors and investors under the framework of donor harmonization. Nepal's desperate move for the attraction of FDI raised interest among the international investors. As a result, in 2002, meeting of Nepal Development Forum (NDF) was organized under the joint chairmanship of Nepal and the World Bank (Bhattarai, 2012). The constitution of the kingdom of Nepal 2072 has also incorporated the policy of attracting foreign investment for the development of nation (The constitution of Nepal, part 4.10/11). It becomes clear that FDI is the prime interest of Nepal's foreign policy. Considering the fact Nepal has been participating the international forums in different interval. It has signed Bilateral Investment Promotion and Protection Agreement (BIPPA) with more than half a dozen countries in the world including its both the Neighbors. That are constructed or under construction with foreign investment. Two grand investment summits have already been organized to promote FDI flow for the development of nation. Multi-National Companies (MNC) like Dabar Nepal Limited, Unilever Nepal Limited in the production field and some hydropower projects like Kulekhani Hydropower Project, Kali Gandaki A Hydropower Project, MelamchiKhanepaniPariyojana, Lumbini International Airport etc. are few to mention here. The constitution of the kingdom of Nepal 2072 has also incorporated the policy of attracting foreign investment for the

development of nation (The constitution of Nepal 2072, part 4.10/11).New company act 2075 has eased lots of constrains regarding investment. Recently, Government of Nepal has introduced Foreign Investment and Technology Transfer Act 2019 replacing the previous act of 1992 that helps to promote foreign investment more than the past (Nepal Law Commission, 1992). However in the field of hydropower sector, the FDI flow is still low in Nepal.

#### **4.1 Present Status and Regulatory Framework**

Before the Investment summit in 2019 the status of FDI flow in Nepal was in downward movement. Recent statistics of FDI flow in Nepal has reduced by 63 percentage. However government somehow bounced back in commitment reception during the investment summit. According to the report of Ministry of Industry, during the first eight months of fiscal year 2018/19 FDI flow was limited to only 34.9 billion dollars which was almost 13 billion less than the last year 2017/18 same duration (The Himalayan Times,21 march. 2019). This shows the diminishing rate of FDI flow in Nepal despite having the favorable environment as claimed by the government.

One of the biggest problem or the issue of concern of Nepal regarding the FDI generation is the lack of fulfillment of the commitment of the donors. A total of 3905 industries from 90 different countries have been registered securing approval of NPR 208.04 billion FDI in FY 2016/17. However, Nepal received only NPR 10.15 billion foreign investment in industries in the first eight months of the period. India has the largest share of 39.08 percent in the sum followed by China, Hong Kong, South Korea and British Iceland in the top 5 FDI receiving countries. According to World Investment



Report 2016, Nepal received USD 106 Million in FDI. Moreover, India was the largest recipient in South Asia with a receipt of USD 4,448 Million. Nepal was ranked 6th in the region with a share of 1.03%. Only Afghanistan and Bhutan remain behind Nepal (Doing Business, 2017 –Annex 4). Studies show that good regulatory regime is needed for domestic firms to imply higher FDI (Investment Policy and Regulatory Framework in Nepal, FY 2073-74/2016-2017).The constitution of Nepal directs the state policy to encourage and mobilize foreign capital and technology investment for import substitution, export promotion and infrastructure development to suit its national interests (Constitution of Nepal, 2072.Article 51.10). The ongoing 14th periodic plan has envisioned an innovative, competitive and dynamic economy thorough the mobilization of foreign investment. Foreign Investment Policy, 2014 has set the goal of making national economy competitive and Foreign Investment Act 2075 eased the investment process by giving the responsibility to approve to the Investment Board within a week of application.

#### **4.1.1 Nepal Investment Board**

Nepal Investment Board (NIB) is an autonomous body under the government of Nepal which was formed in 2011 under the Investment Board Act 2010. Its main objective is to facilitate economic development by creating investment friendly environment. It was brought into action with the concept of One Window Policy in investment generation especially in private sectors including FDI generation in industry sectors. But there is big question on its autonomous status. Energy industry sector of Nepal bears key importance in the economic development in the country. It is simply a driving factor to guide the nation towards economic prosperity. Realizing the situation

the government of Nepal has opened the avenue for the private sectors and international investors to invest in Nepal. Nepal government, to ease the problem regarding the FDI and also for the development of energy sectors NIB was established in 2011 by the parliament. It is an administrative body responsible for the development of large infrastructures Development including the hydropower projects capacitated more than 500 MW. The board is chaired by the Prime Minister himself with Finance Minister and other line ministers as board members. It is given legal mandate to make alliance to improve countries investment climate by creating the framework for the selection and evaluation of the project, providing incentives to encourage investments, negotiation concession agreement and carrying out investment promotion activities (Nepal Investment Board Act 2068). Nepal investment Board shows the prospect of energy trade in Asia as Asia is trying to replace the use of fossil fuel in sustainable amount. Foreign investors can keep their eye open for that prospect (Nepal Investment Board Act 2068).

Government of Nepal and even private Sectors in Countries are not capable enough to invest in huge infrastructure projects in Nepal. Due to this Nepal Government has given priority to FDI generation for the development of infrastructures in the country. For this The Constitution of the Nepal 2072 has made clear policy directives for foreign investment (Constitution of the Nepal 2072). Foreign Direct Investment (FDI) plays a crucial role in nation's economy along with other Portfolio Investment as it directly affects the domestic economy and production mechanism. Every economy in the modern world is trying to attract FDI putting the best ever effort by launching conducive policies and business environment that is essential. Hence, FDI is one of the key elements required for sustainable growth and development of the country and Nepal is no

exception in this regard. The initiation for FDI was taken in Nepal in 1981 through the Foreign Investment and Technology Transfer Act. After the political change in 1990, Nepal adopted liberal economic policies and steps were taken to attract FDI accordingly (Bhattarai, 2012).

#### **4.1.2 Ministry of Foreign Affairs**

Ministry of foreign Affairs plays key role in FDI generation in Nepal. It diplomatically presents its prospective in international forums, seminars and conferences. It arranges the bilateral negotiations, multilateral negotiations and visits of different states dignitary that sets the environment in bilateral agreement. Its main responsibility is to promote national interest according to the constitution of the country. There are numerous Embassies in the world which work under Ministry of Foreign Affairs. Their main function is to promote national interest in international arena. Those diplomatic missions always work hard for the economic diplomacy (Hamal, 2010). Until 2019 Nepal has developed diplomatic relationship with 168 countries which has become the mile stone to promote national interest in international community. (MOFA, 2019). Though MOFA seems to be the major players in diplomatic field there are other ministries and department that play very significant role in economic diplomacy especially in FDI generation.

#### **4.1.3 Ministry of Energy, Water Resource and Irrigation**

Ministry of Energy, Water Resource and Irrigation is the most responsible agency to develop energy related industry. For that it has a separate department to promote energy development. The department is responsible for the development and implementation of policies, programs and projects on renewable energy, electricity and

power development in order to facilitate socio-economic development. Ministry has established multiple units to develop energy with different nature. In order to promote hydropower development in the country Ministry of Energy drafted Hydropower Development policy 2049. The main objective of the policy was to generate hydropower in country to provide electricity in the rural areas of Nepal, development of hydropower to fulfill the need of hydropower in industry and domestic use in Nepal and to motivate the foreign and Nepal investors to invest in the field of hydropower development. The policy of the Ministry followed to achieve the main objectives were; to carry out hydro power projects of various standards and capacities to meet the interim and long term electricity requirements, to give emphasis to the program of rural electrification in order to render assistance in the development of agricultural production and cottage and small scale industries in the hill and Tarai regions, to give emphasis to the development of transport system to be run by hydroelectric power in order to substitute the petroleum products, to utilize the indigenous labor, skill and resources as well as foreign investment and technology for the development of hydropower, to export hydroelectricity produced in excess to the national demand, to extend the use of electricity for making the minimum utilization of fuel wood and to render necessary assistance in the conservation of forest and environment, to diversify the utilization of electricity, to make the supply and distribution of electricity regular and reliable. This policy also formulated the modality, tenure and categorized the investment either foreign or domestic (Hydropower Development Policy 2049). This makes very clear that ministry is working heavily on hydropower generation accepting it as the fundamental element of infrastructures development. Similarly, the Ministry drafted the second policy to develop hydropower in

2058 with some reformation in the earlier policy. The main objectives of the policy were almost similar to the earlier policy. Hydropower Development Policy 2058 focuses on the development of hydropower for the country's prosperity. Statement is clearly given in preamble of that policy (Hydropower Development Policy, 2059).

In the case of domestic consumption and also in the field of export possibility, hydropower development is the most heated issue in the country. After the restoration of democracy in 2046, an open and liberal policy is being adopted in hydropower development. That shows the positive indications in the field of hydropower development. Government has been encouraging the private sectors to invest in the energy sector, especially in hydropower development. With the help of hydropower development, Nepal could accelerate the economic development with in the short period of time. For that government should focus on bilateral and regional cooperation with prime considerations to the national interest of Nepal. One window policy needs to follow strictly to facilitate the industrial entrepreneurs. But it is not seen at present. Domestic and foreign investors from private sectors have been encouraged by the government but there is no proper outcomes (Bhattraai, 2012).

Ministry has promulgated Hydropower Development policy with some objectives as the guidelines for working effectively as to generate electricity at low cost by utilizing the water resources available in the country, to extend reliable and qualitative electric service throughout Nepal at a reasonable price, to tie-up electrification with the economic activities, to render support for the development of rural economy by extending the rural electrification, to develop hydropower as an exportable commodity all these objectives are based on the realization of need of hydropower development in the country

(Hydropower Development Policy,2058). To encourage the investors in the field, government through the Ministry of Energy, Water Resource and Irrigation and Ministry of Foreign Affairs has prepared the Hydropower Investment policy 2075 targeting private sector investment and also as the guidelines for international investors (Ministry of Foreign Affairs, 2018). To achieve the targeted goal, government has made some strategies like; Extending the hydropower services to the rural economy from the perspective of socio-equity with the realization of the fact that development of power sector, having a direct concern with agricultural and industrial development, is a pre-requisite, pursuing investment friendly, clear, simple and transparent procedures so as to promote private sector participation in the development of hydropower, also taking into account internal consumption and export possibility of hydropower, implementing small, medium, large and storage projects for hydropower development focusing on national interest, environment protection and maximizing benefits in the development of water resources of Nepal, developing hydropower projects by attracting investment from private sector as well as from governmental sector, as required, and through joint ventures of government and private sector for the promotion of hydropower development, making the river basins of specific rivers as the basis of development and management of water resources in order to achieve maximum benefits from the utilization of water resources of Nepal, pursuing a strategy of bilateral or regional cooperation in the hydropower development sector taking into consideration the feasibility of hydropower in Nepal and the demand of electric energy in neighboring countries in view of the fact that development of hydropower in Nepal supports not only the domestic but also the regional economy, adopting a broader perspective on national development in the context of

macro-economy in developing and managing hydropower in line with the concept of developing water resources in an integrated manner, minimizing the potential risks in hydropower projects with a joint effort of government and private sector, and to make provisions for allocating the non-mitigated risks to either the government or private sector based on their capability to bear the risk at the lowest cost.

In order to develop hydropower and to attract the private sector and international investors in the development of hydropower government has made some policy guidelines. The first policy plans to meet the domestic demand of electricity. Second, for domestic use as well as the storage projects as per requirement on competitive basis. Third policy aims implementation of hydropower projects based on the concept of Build, Operate, Own and Transfer (BOOT). Fourth policy is based on incentive provisions, fifth on multi-purpose projects, sixth irrigation development, seventh for an alternative to biomass and thermal energy and so on up to twenty second (Nepal Hydropower Development Policy, 2058).

#### **4.1.4 Ministry of Industry, Commerce and Supplies**

Main role of the Ministry of Industry, Commerce and Supplies is to provide easy procedural prospects for the intended investors in the field of that interest under the national industry policy. There are numerous acts drafted by the ministry about Company formation registration, types of investment.

The Industrial Policy, 1992 was introduced for the first time there was huge hope among the people that Nepal will speed up for the development and promotion of industries. It was framed with only objective of accelerating the growth of industrial sector. However, there has been no significant progress achieved in any form of industry

in Nepal. The trend of industrialization is rapidly growing in the developing countries even in our neighborhood the rate of industrialization and economic growth is increasing in speed. With the realization of some lacking the new Industrial Policy, 2010 is formulated with the objective of bringing positive changes in overall economic and social sectors of the country by means of rapid industrial development doing away with the weaknesses of the past. It is expected that through this Policy, activities of industrial development will be increased; employment opportunities will be massively created and the level of income of people will be increased so that contribution of industrial sector in economy of the country will be at the forefront (Industrial Policy, 2010).

Keeping the hope of achieving objectives set by the Industrial Policy, 1992, transformation of the economy that was substantially relied on agriculture it is needed to bring great transition in agricultural system. Therefore, efforts were made to concentrate governmental activities on agricultural development to build the foundation of industrial development. The Industrial Enterprises Act, 1992 enacted as directed by the Industrial Policy, 1992, that created legal basis for development of industries by introducing the system of additional facilities and concessions like in income tax, sales tax and excise to the prescribed industries of various classes and located in various regions having them classified and prioritized with a view to move forward industrial development with high priority. However, because of various reasons, the facilities and concessions provided by the Industrial Enterprises Act, 1992 could not be continued and those facilities and concessions were gradually minimized and repealed with the first amendment to that Act, the Income Tax Act, 2002 and the Fiscal Acts enacted year by year. Despite of these



facts, the efforts to make the industries competitive by making available to them other institutional and basic infrastructure services were continued.

In order to promote economic development with the development of industries, the National Productivity Council was formed as an institutional arrangement and the concept of Special Economic Zone was introduced. The Main motto of declaration of special economic zone was simply to provide security, and to promote the industrialization with availability of resources and raw materials. In this connection, the then provision of compulsory licensing for establishment and operation of industries was repealed and it was provided that no license or permission would be required to establish industries other than the prescribed industries. It was expected that these measures would create conducive and competitive atmosphere for establishment and operation of industries, and industrial productivity and employment opportunities would be enhanced. In order to make more contribution in industrial development, various efforts were made such as capacity development of laborers, enhancing managerial skills, encouraging the use of new technology, increasing sectorial investment, making provisions for restoration of sick industries, imparting trainings for entrepreneurship promotion and making necessary institutional arrangement for providing services and facilities from one window policy(Nepal Investment Policy2010). Ministry of trade plays important role in generation of FDI as trade facility is the means of gaining profit from investment. Working for the timely change in the trade policy to ease the challenges regarding the trade that leads foreign investors to invest enthusiastically in Nepal. In the case of hydropower development, the total production cannot be utilized inside the country. It needs export facility to its neighboring market. Different bilateral and multilateral trade

agreements are needed to sign. Accordingly, Nepal has entered in multilateral and bilateral forums Like SAARC, BIMATEC and now has signed BRI with China (The Rising Nepal, 7th March 2020). Government has been working for renew and upgrade of Trade Policy 2009. for that Steering Committee under the Chairpersonship of Commerce Secretary and Technical Committee under the Chairpersonship of Joint Secretary was formed to oversee and draft the New Trade Policy in 2015 that committee drafted a new trade policy in 2015 with lots of new provisions to replace few old ones. The main objectives of Trade Policy 2015 are:

- To achieve economic prosperity by enhancing the contribution of trade sector to national economy through export promotion,
- To achieve inclusive and sustainable economic growth through export promotion,
- To strengthen supply-side capacity, and minimize trade deficit by increasing exports of value-added competitive products and services in the world market,
- To enhance access of goods, services and intellectual property to regional and world markets.

Government of Nepal only plays the role of facilitating and safeguarding the process by helping to guaranty security, protection of intellectual property rights and other legal process. Government shall play the role of coordinator, facilitator and regulator to enhance active participation of the private sector. It should enhance competitive capacity of the products of comparative and competitive advantage for export promotion. Work for the issues like tax, tariff in export promotion and entrance to

the world global market (Trade Policy 2015). Those policies are encouraging changes in FDI generation in Nepal.

Those policies and the institutions are working since their existence still the economic prosperity is yet to achieve. There is a need of further research that despite having all the institutional bodies and policies why economic diplomacy especially in the field of FDI generation in hydropower sector is not accelerated in the country? Are there still some flaws in policy level? Is NEB getting real autonomous status? Is there institutional co-ordination in FDI generation? Is one window policy implemented properly? These aspects are in the need of further research.

## **4.2 Recent Attempts of Economic Diplomacy**

Realizing the immediate need of energy development, Nepal is trying to attract foreign Investment in hydropower development. After the end of arm conflict for ten years Nepal is heading towards permanent peace. Investment environment is becoming favorable for investors. Government has made some attempts to attract foreign investment in recent time that are discussed here.

### **4.2.1 Nepal Investment Summits**

Nepal Government has been putting lots of efforts to flourish economic diplomacy. Diplomatic relationship has been established with many new countries, lots of high level diplomatic visits and state visits have been exchanged with possible donors and even to immediate neighbors. Even at the level of bureaucracy especially from the Nepal Electricity Authority delegates have visited to different countries including India to talk to same ranked office and officials (The Kathmandu Post, October 17, 2019).

However, the Government of Nepal has hosted two investment summits to attract foreign investors in as the prime means of economic diplomacy after the establishment of Republic in Nepal. Still flow of FDI has not been as per government expected especially in the field of hydropower generation (The Kathmandu Post 17<sup>th</sup> Oct.2019).

Government of Nepal in collaboration with the Ministry of Industry and Nepal Investment Board organized first investment summit in 2017. The post -earthquake summit was organized with the hope of drawing the world investors for investment and bring back the Nepalese economy back in track. Government promised conducive environment for investment in the country. The Joint effort of Ministry of Industry, Investment board and National Planning commission got huge response from international investors and private sectors. Prime minister, Former Prime ministers, leaders of different political parties unified say in the issue (The Kathmandu Post, 2March, 2017). In the summit total 17 investors signed letter of intent with investment promise of about 14 Trillian investment was committed. However only 25% of which was received. The commitment was undouble great but the execution is not as per expectation.

Nepal Investment Summit 2019 was organized with huge expectation that government will be able to convince the international investors to invest in Nepal as the political stability and security situation of country is in convenient to invest. Lots of huge projects were in showcase. The projects like; East-west electric railway, Metro rail in Kathmandu and in hydropower sector, Sunkoshi Hydropower Project and West Seti Hydropower project were the area of FDI generation. Nepal expected to sign at least twelve MoU including two hydropower project and result was more than expectation that

Nepal signed fifteen MoU in total but hydropower sector could not attract any investor in the summit (Nepali Sansar, April 1, 2019).

Though government assure investment security at its fullest still could not drag the intended amount especially in hydropower sector. The major cry of political instability and internal conflict was over but investment was very nominal. Similarly, in Nepal Investment summit, different investors signed MOU in about half a dozen hydropower Projects like; Arun Third hydropower project, which was already declared to be constructed by India, Upper Trisuli Hydropower Project, Kaali Gandaki Hydropower Project, Api Power company and few others but not in the project the government's priority. NRN England Promised 10 Million Nepali currency. However the expected result is not seen in hydropower sector (The Spotlight, 31march, 2019). The reason behind lack of interest in hydropower sector might not be limited to security and political stability rather other factors like issue of geographical conditioning, cost of cross border transmission line and more importantly the diplomatic factors can be contributing in the mind of investors especially in the field of hydropower development.

#### **4.2.2 Formulation of Foreign Investment and Technology Transfer Act,**

Government of Nepal has drafted new Foreign Investment and Technology Transfer Act 2075. Act hopes to increase foreign investment through maximum mobilization of means and resources. It hopes sustainable economic development attracting foreign capital (Nepal Law Commission, 2019). This act is based on public private partnership model that can encourage private sectors to invest in infrastructures including hydropower development. It has the provision of separate legislation in different sector of investment. The act provides minimum cap of individual investment

500000 million dollar. Non Residential Nepali are also given status of foreign investor including their farm and company. The limitation of investment is reformed from share investment in foreign currency, reinvestment and loan investment to many facilities like; secondary share investment, lease, loan, share and many more (Upreti, 2019). Investment security is guaranteed by BIPPA agreement with different countries. These are the recent positive attempt made to encourage foreign investors to invest in Nepal.

## CHAPTER 5

### STATUS OF HYDROPOWERS BUILT UNDER FDI

After the introduction of Foreign Investment and Technology Transfer Act 1992, Nepali people expected the huge change in the energy sector of Nepal, still the problems are almost similar. Many times the policy and the acts have been reformed but the flow of FDI is not received as expected. Many different international institutions like ADB, World Bank etc. and the governments like China, India, Japan, Russia, America, Britain etc. have shown interest to invest in Nepal in different projects and even signed the Memorandum of Understanding (MoU) but later withdrawn. Sometimes it happened by informing the government and sometimes without giving formal information for a long time. This shows that the construction of large scale hydropower projects has been a controversial issue in Nepal. Country possesses the huge potential in hydropower sector that is the expectation of people to generate economic pace towards prosperity. However this sector created uncertainty not only among the people around the project area also among the people of this country. As soon as the projects are announced they are surrounded by the controversies and project implementation process is halted in the planning phase. The controversies in outlook are on either in its costs or benefits or in the issues like environmental impacts, social impacts, compensation, displacement, resettlement and agreement between Nepal and India in water, energy and other benefit sharing (Kantipur Daily, 31March2017). The controversy is always with the large scale hydropower projects like Arun iii, West Seti, KarnaliChisapani,Pancheswor, Upper Karnali etc. that are with capacity of More than 200 megawatts.

Nepal has generated more than 1100 Megawatt Hydroelectricity until 2019 (Nepal Electricity Authority, August, 2019). This is not enough capacity to consume in domestic level. Expected hydropower generation at the end of 2019 was 1850 megawatt (The Kathmandu Post, 2018, August 17) but the target is not achieved due to the delay in the mega projects like Upper Tamakoshi Hydropower project. The result, Nepal has been importing energy from India where it planned to export in the future. Though theoretically Karnali and Mahakali basin jointly capacitated about 36000 megawatt, Gandiki 20000 megawatt, Koshi 22000 megawatt and others more than 4000 megawatt production is completely nominal (Kaini, p.& Annandale, G, 2019). The projects carried out under foreign investment never completed in planned schedule that is why present status of hydropower generation in Nepal is below the expectation. Upper Tamakoshi, one of the largest hydropower project is facing delay and West Seti hydropower project another huge project capacitating 950 megawatt is also uncertain (Kaini, p.& Annandale, G, 2019). These are few examples to understand the jeopardy of hydropower development in Nepal at present. Reasons for underdevelopment in hydropower needs close study.

### **5.1 Kali Gandaki A: A Successful Project under FDI**

There are few hydropower projects built with foreign investment. Few of them are brought at glance in this research.

#### **5.1.1. Introduction**

Kali Gandaki 'A' hydropower project is one the major successes of Nepalese economic diplomacy. It is the very first mega project launched in Nepal. The Project is situated at Mirmi of Syanja district. It falls about 300 K.M. west from Kathmandu, the



capital of Nepal and about 100 K.M. west from Pokhara. This is one of the biggest hydropower projects built with the economic cooperation of Asian Development Bank (ADB). This hydropower project is simply the outcome of the country's prime policy of energy development for the promotion of economic activity and use of energy in domestic purpose. Project is based on run up river type started in 1997 and completed in 2002, with in five years of its formal beginning. The primary objective of the Kali Gandaki “A” Hydroelectric Project was to help meet the increasing demand for electricity in Nepal in an environmentally sustainable, socially acceptable, and least-cost manner. The Project’s other objectives included improving the operational and financial performance of the Nepal Electricity Authority (NEA), the Executing Agency (EA), through attached Technical Assistance (TA) and a non-technical loss-reduction component, and improving NEA’s cost recovery through enhanced retail tariffs that promote efficiency in power consumption (ADB Project Report on KaaliGandaki A,1996).

### **5.1.2. Short Description about Project**

The Kali Gandaki River flows in a U-loop for more than 45 kilometers across a 6 km wide from Mirmi to Beltari in central Nepal. The elevation from Mirmi to Beltari drops about 108 meters, which is utilized by the Project to generate electricity. Dam of this project is constructed at Mirmi, to divert some of the water into a tunnel. The tunnel conveys the water to a 144-megawatt (MW) surface power station in Beltari. The Project has built sufficient storage capacity behind the diversion dam to operate at its full capacity for six hours a day, even during the dry season. This Hydropower Project has a 44-m high concrete gravity diversion dam and gated spillway, and an adjacent intake and

descending basin, a 5.9 km long concrete-lined headrace tunnel with a diameter of 7.4 m, a surge shaft, pressure shaft, tunnel leading to the power station and the power station, hydraulic steelworks including the supply of gates for the spillway, descended, headrace tunnel and power station, as well as the steel liners for the pressure tunnel, electrical and mechanical plant and auxiliaries for the three 48-MW turbo-generating units, transformers, and switchgear to be installed at the power station; and two 132-kilovolt (KV) transmission lines, one to Pokhara (61.4 km) and the other to Butwal (44.3 km). The Project got grant in Technical assistance for environment protection and second for NEA's capacity building in technical field (ADB Project Completion Report on KaaliGandaki A, 2004). This project is a perfect example of aid for hydropower development that encourages foreign investors to invest in Nepal.

### **5.1.3.Relevance of the Project**

Kali Gandaki 'A' hydropower project is one of the successful hydropower projects built under International Investment. It is an example of success in economic diplomacy from the government. The Project was made possible to build after the introduction of Hydropower Development Policy 1992 by The Government of Nepal. The main Objective of the Policy was to develop Nepal's large hydropower potential in an environmentally sustainable manner to meet the country's energy needs, and to export electrical energy to generate revenues. The Policy opened the avenue to the international investors to invest in Nepal in different modality. Asian Development Bank (ADB) showed its interest on the project for the first time. ADB came to Nepal with special mission and strategy to reduce poverty by promoting sustainable and environmental friendly economic growth enhancing the policy to promote private sector participation in

development. The power shortage in Nepal at that time had become major constraint to economic growth and employment generation. ADB's wanted to assist Nepal in exploiting its water resources in an efficient and cost-effective manner. The Project was designed to minimize load shedding of the country. The first feasibility study was completed in 1979, and updated in 1992 with assistance from the United Nations Development Program. NEA then proceeded with detailed engineering and the preparation of tender documents with ADB assistance for consulting services (ADB Project Completion Report on KaaliGandaki A, 2004)

#### **5.1.4 Project Costs**

The project was launched with the modality of Joint partnership between government of Nepal and international investor. The major investors are ADB and Japan Bank for International Development. They provided soft loan for the construction of the project. The estimated cost of the project at appraisal was \$452.8 million, of which \$320.0 million (or about 71%) was in foreign exchange, including \$7.9 million for service charges and interest during construction; and \$132.8 million (or about 29%) was in local currency costs, including duties and taxes. ADB provided a loan of \$160.0 million equivalent from its Special Funds resources to finance 50% of the foreign exchange cost, including service charges during construction. The Japan Bank for International Cooperation (JBIC) provided a loan of \$160.0 million equivalent to cover the balance of the foreign exchange requirement. ADB and JBIC financing totaled \$320.0 million or 71% of the project cost. The Government and NEA, through internally generated sources, funded the remaining cost of \$132.8 million equivalent. The ADB loan financed the civil works packages like; construction engineering, project

management, environmental mitigation, and the loss-reduction component. The Project Completion Review (PCR) Mission estimated the completion cost of the project to be \$354.8 million, with a foreign exchange cost of \$241.3 million (or about 68% of the total) and a local currency cost of \$113.5 million (or 32%). ADB funded \$140.7 million, or 40%, of the project costs; JBIC funded \$100.6 million, or 28%; and the Government funded \$113.5 million, or 32%. The appraisal estimate included physical contingencies and provisions for price escalation on the foreign exchange and on the local currency costs. It also included an estimate of the interest and service charges during construction. ADB provided loan at an interest rate of 10.25% per year, repayable over 25 years, including a grace period of 5 years. On 23 September 1997 ADB approved NEA's request that the Loan Agreement be amended to increase ADB financing of the foreign currency portion of the loan for civil works from 82% to 89% (ADB Project Completion Report on KaaliGandaki A, 2004, pp.3-4).

#### **5.1.5 Project Schedule**

In the beginning the Project was estimated to complete in 4.5 years that is by 15 January 2001. But it was delayed as it is customary in the context of Nepal. The Excavation which was supposed to be started in May 1997 but due to the late mobilization of the civil works contractor, it started in August 1997. The project faced delay due to the conflicting relationships involving NEA, the project implementation consultant, and the civil works contractor. Each one blamed the others for delaying implementation. As a result, effect was seen in decision-making capability that caused delay in timely implementation of the Project. The power plant was physically completed in May 2002 about sixteen months later than the physical completion target at

appraisal. Commercial operation began in August 2002. (ADB Project Completion Report on KaaliGandaki A, 2004). There were lots of obstacles on the project. It also faced delay due to rehabilitation and some other technical issues. However, this is the first successful hydropower project built under Foreign Direct Investment in Nepal, an example of successful economic diplomacy. But except that projects under FDI faced huge controversy.

### **5.2 Arun Third Hydropower Project**

Arun Third hydropower project is located in eastern part of Nepal in State one. It lies in Shankhuwasabha district. Total production capacity of the project is 900 megawatt. It is a run of river project with 3.65 hours minimum picking capacity. It was identified for the first time by Japan International corporation Agency (JICA) during early 80s. The project was prepared as Least Cost Generation Expansion Plan. Before the integration of Arun Third there were altogether seven hydropower projects in the same Arun River. Due to the lack of road facility, the construction of all projects would become costly. So, with the recommendation of World Bank, the main donor, all the projects were integrated. In 1987 World Bank agreed to invest in the project. Project was taken as the best in terms of economic as well as technical perspectives. The project was the project of high priority during the Panchayat Regime and it also got priority even after the establishment of democracy (Thapa, 2011).

After the introduction of aid culture in Nepal, Government and the donors agreed in the agendas of launching the large power plants projects. They focused on the centralized planning in order to meet the rapidly increasing demand of electricity to address the increasing need of energy in increasing neo-urbanization and also growing

industrialization. Arun Third came in this wave. After the restoration of democracy in 1990 World Bank showed interest in the rapid execution of the project which was already planned to build under its investment (Mahat, R.S. 2005).

The newly elected democratic government of 1991 also put this project in high priority as it was thought the first step towards the development and progress. But government didn't have capacity to invest huge amount for the project. The lack of capacity resulted on breakdown of the capacity of it. Mahat writes; considering the fact that Nepal could not invest huge amount in the project, it was planned to build in two different phases capacitating 201 Megawatt in each. The project was real hope for Nepal's economic and energy sectors because it was based on run-up-river project that could generate almost similar (85%) amount of energy in both the rainy and winter season. Project had prospect to become a boon for the Nepali people that facing the load shedding problems especially during the winter. (Mahat, 2005).

But after the formation of newly elected government project started to face controversy. The issue became completely a political agenda rather than the economic. It became the issue of ownership whether the project was launched by the democratic government or by the then Panchayat. At the same time then state minister of water and energy of the government of Nepal criticized the project on the opinion that the project was launched by the Panchayat Government. Still the government supported the project as two very prominent ministers including the finance minister were supporting it (Thapa, 2011).

This project was simply the dream project for Nepal as government found new way to fulfill the accelerating demand of energy for domestic as well as the industrial use.

The most attractive feature of this project was the firm energy it could generate throughout the year. The other projects were simply the high cost small hydropower generating 60% at the optimum level during the dry winter season. Arun III could generate about 85 percent of the firm installed capacity. This shows that project was boon for the country. In 1994, the cost of the project was determined US \$ 1.08 billion, of which about two third was committed to invest by outsider investors, entirely in the form of grants and soft loans. The principal donors included the IDA (\$175 million), ADB (\$127 million), Germany (\$125.4 million), Japan (\$150 million), and France, Switzerland and Finland (\$ 46 million). Among those outside investors Germany agreed to provide grant and other countries like Japan and even World Bank agreed to provide soft loan payable over a period of 30-40 years at less than one percent service charge. Others were grant-cum-credit. Altogether, estimated about seventy percent of total cost was from subsidy in it and the annual power generation from the project at the prevailing power tariff at that time would yield approximately five billion rupees. The debt servicing obligation and operational costs of the project would take about one fifth of this revenue, leaving approximately four billion rupees as net revenue to the Government for investment in other priority sectors (Mahat, 2005).

Overall the project was not only the hope for Nepali people but also the biggest opening for international community to invest here. But it was cancelled in 1995 when World Bank stepped back from investment in the project. After that Government many times tried to convince the in termination community to invest in the project accordingly in 2006 opened the Build, Own, Operate & Transfer (BOOT) model of investment to attract the investors from international community. In 2007 SutlajJalVidut Nigam

Limited, India shown the interest on the project and submitted the expression of interest, that later on in 2008 was selected to build Arun Third with revision of the total generation of electricity to 900 Megawatt. But the project was still vandalized by the company. And finally in 2018, India got the project again and was inaugurated jointly by the Prime ministers of both the nations on March 11, 2018 (The Kathmandu Post, 11 March 2018).

Arun Third Hydropower project is one of the cheapest project designed to build on run-up- river modality. It was geographically better area to carry the construction activities. It was quite beneficial project with high level of sustainable productivity. Its power generating capacity is also almost similar in both the seasons, 80% during dry season. There was not a problem of financing of the project because international reputed investors like World Bank and JICA were ready to invest. It was supposed to begin during early 1990s and complete within five years from its beginning. However, the project has gone through unprecedented controversy and disturbance in national and international level. Many NGOs, INGOs and social and political activists resisted the implementation of the project. The whole world formed its own judgment on the procedure and environment of investment in Nepal especially in Arun Third hydropower project (Thapa, 2011).

There were different interest groups who aggressively lobbied against the projects. Commission agents to political cadres came against the project. One group was the commission agents of Thermal plants who felt that if the project is launched their commission from the Thermal Plant will be lost. They raised the issue of nationality and national sovereignty. Finally, they started anti-Arun campaign. Second group was the group of different NGOs and INGOs who raised the issue of environment and started to



agitate against the project in local, national and international level. Domestic politics was also affected badly by the project. It became the issue of conflict in the contemporary parliament between the ruling and opposition parties, especially the main opposition party. The controversy took a political turn when opposition in the parliament also criticized the contemporary government for promoting the project without creating a national consensus and studying alternative scenarios. Everybody was suspicious on commission money as the main reason behind protest of the project. The controversy became so extreme that it dragged the National planning commission (NPC), the policy making body in the process. Critics blamed NPC for promoting and prioritizing mega projects without doing proper research on hydropower sector. NPC was accused for neglecting the small scale projects that can be lunched utilizing domestic resources. However, the controversy was promoted by the NGOs and INGOs with some vested interest. Some of the lead international NGOs opposing this project were UK and USA based International Rivers Network, International Technology Development Group, the Globe International, Greenpeace, Environment Defense Fund and Friends of the Earth. Prominent Nepali NGOs opposed to the project included Alliance for Energy, INHURED International, and TheArun Concerned Group(Thapa, 2011).

There was some confusion in main opposition party regarding the project. Considering the increasing controversy and the possible confrontation the main opposition party wrote letter to World Bank requesting some more time for further study on the cost and benefits of the project. It turned out to another reason to delay the project as World Bank took the letter seriously. Question was raised against the mandate of the contemporary caretaker government for making the huge decision. The mid-term election

result created more chaos to the project. The new elected government also could not take the project ahead due to contradiction. The anti-Arun campaign was gaining strength. At the same time management of World Bank changed that formed completely different opinion regarding the project that caused the beginning of new chapter. Government of Nepal tried to keep the project alive making the World Bank to revisit their decision but it could not convince the Investors especially World Bank. As a result on 3rd August 1995, World Bank's new elected President cancelled the project "in agreement with the Government of Nepal". But it promised to invest in some more small scale projects instead of Arun iii. (Mahat, 2005) In cancelling the project, the President gave three reasons, namely:

- I. Concern regarding Nepal's management capability to meet the demands and long list of actions which the project of this size and complexity would involve;
- II. Difficulty in gaining popular support in implementing a number of measures including power tariff and prioritization of public expenditure and;
- III. Difficulty in mobilizing additional \$30-40 million cost overrun as a result of the delay in project implementation. (Mahat, 2005, pp.241)

The reasons were not very convincing, still there was no option left except accepting by the government. Still there could have been negotiation for better implementation, that aspect is not examined properly. This way one of the highly promising hydropower project ended with infinite dilemma. In 2018 the project got revival as India agreed to take the project ahead.

### **5.3 West Seti Hydropower Project**

West Seti hydropower project is one of the mega projects launched in the field of hydropower sector in Nepal. It has the capacity of 750-megawatt (MW) hydroelectricity generation. It lies in the province -7 in Mahakali Zone. It is a storage scheme designed to generate and export large quantities of electricity to India. The Project will generate electrical energy throughout the year, storing excess wet season river flows in the reservoir, and using this water to generate energy during peak demand periods in the dry season.

SMEC International prepared a detailed environmental impact assessment (EIA) for the Project. In 2000, the Ministry of Population and Environment, now the Ministry of Environment, Science and Technology, approved the Project. In 2007, an EIA was prepared for the project transmission line. The 2007 EIA was about to be submitted to Government approval authorities. In 2006/07, a household census and sample socioeconomic survey were undertaken to update the resettlement action plan, while a vulnerable community development plan was prepared to focus on this group. In addition, accumulative impact assessment and disaster management plan were prepared for the Project in 2007 and all costs were updated.

The Project is classified as ADB environment category A, primarily due to the magnitude of resettlement and the adverse impacts on land use and terrestrial and aquatic ecosystems (Environmental Assessment Report-2007). The project was expected to bring enormous change in Nepalese energy sector as well as the economic sector because it could address the growing need for the energy in the country and it also open the avenue of energy trade in India and might be to the South Asian countries like Bangladesh.

Employment generation was another benefit the country could get. According to the agreement the Government could receive 10% of the output of the power station as free power or 10% of the revenue received under the terms of the power purchase agreement in lieu of free power. The Government chose the latter option. The Project is a build-own-operate-transfer scheme, through which the investing company has a 30-year generating license that will provide about 24.5 years of generation before full ownership of the Project is handed over to the Government. This shows that after the twenty five years of production government of Nepal will get Indian market to trade the energy produced by the project if it wants. Commercially it was an opportunity to enrich the economy of the country. The power purchase agreement has a 25-year term from the date the Project starts commercial operation with the average tariff of \$0.04.95/kilowatt-hour at the point of delivery on the Nepal-India border. The main features of the project are a 195 m high concrete faced rock-fill dam, 2,060 hectare reservoir area, 6.7 km headrace tunnel, underground power station, 620 m tailrace tunnel, reregulation weir, switchyard, 20.3 km permanent access roads, and 132.5 km 400 kilovolt (KV) double-circuit transmission line in Nepal; as well as permanent accommodation for up to 200 operation and maintenance staff. That is undouble the beneficial aspects for Nepal. Power will be transmitted from the Project via a 230.5 km 400 kV transmission line. The initial 132.5 km of this line will be located in Nepal, running south from the switchyard to Attariyathen Mahendra Nagar, with the final 98 km heading southwest in India to join the Indian electricity transmission grid at Atamanda, 22 km north of Bareilly. Construction of transmission lines could have been very far from the reach of Nepal government as she is not capable to invest capital and even the human resources. Project construction is

targeted to commence in late 2007 and take 66 months (5.5years) to complete. The total cost of theProject is estimated to be \$1,200 million (Nepal Energy Forum, March 19, 2011).

West Seti Hydropower Project is one of the highly expected energy development projects in Nepal. It was mainly based on the export oriented project that could generate national income through the energy trade to its neighboring country. It is a storage scheme designed to generate and export large quantities of electricity to India. The project faced the same fate as different NGOs played very significant role to defunct the government policy in the field of energy development. At first Asian Development Bank stepped back from the project by showing the environmental issues as well as the humanitarian concern because numbers of NGOs and social organizations were campaigning against the project (Nepal Energy Forum, March 19, 2011). However the social and environmental cost of the project was cost of the project was not at the level of extreme as government could have cooperated in the processes of rehabilitation of almost about 18000 people supposed to be in the need of resettlement. Another possible reasons could be the lack of Transit Agreement between Nepal and China and the geopolitical situation of the country to get easy access to the international market for energy trade (Nepal Energy Forum, 2011).

After the pull back of ADB company from the West Seti Project Nepal government started to persuade Chine Government for the project by using different diplomatic means. Nepal urged China both to build and invest in number of other hydropower projects including West Seti and china also promised to invest in Nepal in 75/ 25% ratio but the promised just remained as promised only, the outcome was almost

equals to none but in the case of West Seti Nepal Government Signed a Memorandum of Understanding with China International Water and Electricity Corporation in 2011 that formally brought China in the project after the departure of ADB (Nepal Energy Forum, 2011).

China also could not remain long even after signing the agreement. It held the project for a long period of time. For almost six year China spent just doing nothing rather than holding it in the name of study. Finally, China also exited from the project after hanging for almost six years and West Seti Hydropower Project remained as the unfulfilled dream for Nepal. China this time concluded the same as done by ADB. The major issues put forward by China were rehabilitation costs, Expense of transmission lines, humanitarian issues and even the environmental issues (Ghimire, 2018). In the case of West Seti project too no further information is given to public regarding why China stepped back from the project. Why government could not stop China is big question in itself. Is it because of lack of proper diplomatic negotiation? This can be an issue to research on.

## **CHAPTR-6**

### **ANALYSIS OF ECONOMIC DIPLOMACY IN FOREING DIRECT INVESTMENT IN HYDROPOWER IN NEPAL**

Nepal has been making diplomatic attempts to attract FDI in hydropower. Two investment summits have been organized since 2014. Government is formally asking international community and investors to invest in Nepal. However there are some constraints in the field of FDI generation in hydropower development due to which diplomacy in FDI in hydropower has not become effective. There are some fundamental challenges regarding economic diplomacy in the field of FDI in hydropower.

#### **6.1 Policy Status**

Foreign Investment and Technology transfer Act 1992 was the first policy introduced to regulate foreign investment in Nepal. It formally opened the way to foreign investors to invest in Nepal. The act encouraged numerous foreign investors to invest in Nepal especially in hydropower sector. However, Foreign Investment and Technology Transfer Act 1992 and other Acts like Industrial Policy Act 1992 couldn't form umbrella act to ease the process of foreign investment covering diverse subjects that are concerned with other various aspects like labor management, taxation, currency exchange and many more. Contemporary tax law, exchange policy, economic policy, political instability and growing corruption discouraged the foreign investors (The Himalayan Times, 27April 2005). One act may not work for others and perfect cooperation among different sectors is needed to bring FDI which was far to achieve. The conflict between Investment Board Act and Electricity Act in Arun Thirdhydropower project and upper Karnali ruined the entire project discouraging foreign investors. Water Resource Act 1992 (WRA) not only

opened the door for privatization but also introduced Build Own Operate and Transfer (BOOT) system. Nepal's investment capacity has been very weak. NEA could not even study a hydropower project without donor's approval. In this situation both the acts; FITT and WRA became the milestone to open the door for FDI in Nepal (Hydro Nepal, 23 July 2018). However, FITT Act was not out of problem. One of the problems in the act was that though one window policy of investment was introduced the foreign investors can invest only in large and medium scale enterprises otherwise hundred percent investment for foreigners was not allowed (Investment Policy Review of Nepal 2018). That not only discouraged foreign Investors but also pushed back the small projects due to the lack of investment capacity of government and the private sectors within the country. Nepal Investment Board was established in 2011 on the ground of Investment Board Act 2010 with the objective of facilitating economic development by creating investment friendly environment. One window policy of Nepal Investment Board also could not function properly as it is made one more institution to practice one window policy. That means one window policy was only to say not to practice. There are multiple actors like bureaucracy, politics, Ministry of industry, and many more interfering the smooth functioning of Nepal Investment Board as one window policy (Spotlight Nepal, Feb. 2019). No technology transfer agreement could be done without multifaceted approval. Another major problem was related to the ownership of land. According to the act no foreign investor or the investment company could gain ownership on the land in Nepal. Same problem was in Bank ownership where only 66% ownership was allowed. That created problem in stability in currency exchange rate for investors. Retail trading, consultant services were not allowed to foreigners that caused problem for investors and



poor taxation policy also became discouraging factor for FDI flow (Investment Policy Review of Nepal 2018). Labor law became another obstacle for the international investors causing low FDI flow in hydropower sector. Company could not hire labor outside from Nepal and Nepali workers after getting appointment engaged in dirty games rather than working with full responsibility and dedication. The company could not fire the workers because Labor law does not give permission to do it. That not only caused delay but also increased in project cost leaving very negative impacts on foreign investors (Spotlight Nepal, February 9, 2019).

Another problem in FDI generation in hydropower is power trading policy. Issue of tariff in energy trade has been one of the major challenges to be addressed by Nepal in order to attract FDI in hydropower. In 1994 Electricity Tariff Fixation Commission was established to address the tariff related challenges but it could not work in the field as it was not an independent or autonomous in itself. Every attempt the commission made to solve the problem was interfered by different bodies. Further it did not have any jurisdiction to address the issues in huge trading or trade in bulk neither it had authority to deal the issues related to import and export tariff. In 2017 Nepal Electricity Regulatory Commission Act was promulgated to ease the problem but yet to be implemented practically (Hydro Nepal, July 2018).

After the establishment of republic governing system government of Nepal introduced new investment policy drafting Foreign Investment and Technology Transfer Act 2019. The new act was introduced prior to the Nepal Investment Summit 2019. With this act other supportive acts like Public Private Partnership Act 2019, Special Economic Zone Act 2019 for proper coordination and rapid decision making because the past

experience of coordination between and among the different sectors was not properly managed. Foreign Investment and Technology Transfer Act keeps the provision of approval of FDI within a week and one stop policy was supposed to carry out by Ministry of Industry as a sign of coordination. However problem lies in the determination of jurisdictions in the project with 200 MW and Above 6 billion Nepali rupee between Ministry and Investment Board of Nepal. That confusion has to be resolved for better result. Another problem is regarding the changing currency value of Nepal. Hedging rules are introduced to ease the problem but it is applicable in limited critical infrastructure sectors. Prime Minister's direct involvement in approval of FDI according to the new act is not scientific rather there should be a committee to evaluate and approve it. If prime Minister himself comes into play then there is no significance of forming investment board with autonomous jurisdiction. This kind of policy is another challenge in FDI generation. Similarly, the Act does not promote FDI in small scale projects which is another drawback in the policy (The Kathmandu Post, March 22, 2019).

Nepal has drafted many new acts and laws to attract FDI in the country but investment environment is still not risk free. There is problem in security, economic infrastructures and policy implementation that is the reason investing in Nepal is still in risk. The corruption level, limits on the operation of foreign banks, limitation in repatriation of profits, human resources, immigration policy etc. are still the discouraging factors for foreign investors in Nepal (U.S. Department of State, 2019). Holding the project after getting approval and power trade agreement is also a problem in hydropower development and FDI generation. After getting approval and license for hydropower generation many investors keep holding the project without beginning the project in time.

Sometimes they hold such a long time and finally step away from the project. Arun Third hydropower project, West Seti hydropower project, Siddhakali hydropower project are few to mention. The policies are failed completely to generate FDI in hydropower (Hydro Nepal, July 2015). There is a need of appropriate policy to address that kind of challenge to make investors responsible towards the timely completion of the project.

## **6.2 Resource, Cost and Infrastructures**

Economic diplomacy of Nepal has been facing challenge due to the geopolitical situation of the country. As it is land locked country, there is no access to international market without using either Indian or Chinese land. Cross border transmission lines needs to be built for energy trade which should be built either through India or through China. Unless the transmission lines are built the energy trade is not possible. International investors cannot afford to build such transmission lines for energy trade even to its immediate neighbors. History of Indo-Nepal energy trade goes back to 1971. Power exchange is taking place through about two dozen of interconnection lines with different voltage capacity. But it is not at the level of trading rather it is just for the fulfillment of very common energy need. India is buying energy paying more than their domestic charge, in this situation it cannot afford to build high power transmission lines to import energy from Nepal. Nepal Electricity Authority is selling electricity at the rate of 7.98 Nepalese rupee per Kilowatt to India whereas NEA's average power purchase rate is 7.52 Nepalese rupee. India is providing electricity to its citizen in 6.40 to 8.48 Nepalese rupee to its people. This shows that cost of building transmission lines and tariff adds more expense for India in the trading relation with Nepal (The Rising Nepal, 31<sup>st</sup> March, 2020). That is one of the reason India is not willing to build powerful cross border

transmission lines for energy trade. India has also passed a bill concluding not to purchase energy from Nepal if it is produced by any other investors except India. The decision came immediately after the changing dynamics of Nepali politics drafting new constitution ignoring its neighbor's concern. Furthermore India is claiming that it has power excess from 8 to 12 percent from the early 2000s. It also plans to generate 175 GW of renewable energy by 2022 to fulfill the commitment as stated by Paris Agreement. Nepal on the other side lacks domestic market for power and uncertainty of Indian market simply discouraging world investors to invest in hydropower sector in Nepal. Impact started to be seen as Norwegian Company stepped back from 650 MW Tamakoshi Third and China's step back from 750 MW of West Seti hydropower Project.(NIKKEI: The Asian Review, September20, 2019). Bangladesh also is interested in purchasing energy from Nepal. It officially stated the interest. Bangladesh has agreed to buy electricity of Upper Karnali Hydropower Project 900Mw from GMR which got license of the project in 2008(The Rising Nepal, 21Nov, 2017). For cross border transmission lines India has to agree to build it. China is also interested in energy trade from Nepal. It agreed to build high power transmission line from Nepal to China. Both the countries has formed the joint technical team to expedite the construction of the very first ever cross-border transmission lines, the 400 KV The trans-Himalayan transmission Lines from Rasuwagadhi to Kerung. But the most hyped joint partnership has become cold when It clearly denied to fund or to provide grant to build it (The Kathmandu Post, 21Nov, 2017).This shattered the dream of Nepal as trading energy to China is still far from the reach of Nepal. India plays very significant role in the generation of FDI in hydropower in Nepal. Without Indian conscience it is not possible to develop hydropower in Nepal.

The Power Trade Agreement (PTA) was signed between India and Nepal in 2014 to carry out smooth energy trade still India is not willing to purchase energy from Nepal from non- Indian invested projects (Hydro Nepal, July 2018.p.11). Arun Third is one example which faced huge controversy when ADB was there to fund in the project. Different NGOs and INGOs came against the project and even politically it created huge impact and ADB had to step back. The same project has taken by India silencing all who were against the project when it was almost began way before the restoration of democracy. West Seti and Tamakoshi Third are also the example of it. These developments show that due to geopolitical conditioning especially causing high cost in constructing cross border transmission lines it has become huge challenge to attract FDI in hydropower sector in Nepal.

Human Resources and technological expertise is another challenge of economic diplomacy especially in FDI generation in hydropower development. Nepal lacks skilled human resources needed for the hydropower project. Having enormous possibility of energy trade the education system is not focused on technological bases that causes the deficiency of technical experts in the field. Investors should pay huge sum of money to hire technical experts from their country as the salary should be paid in their currency not in local currency and their settlement cost becomes very high. Further lack of economic and physical infrastructures and unstable exchange rate also cause more problem in FDI generation as investors afraid of such things. Lack of skilled labor force and technological expertise, regulatory barriers, inadequate physical infrastructures, exchange rate variability etc. are the major concern of investors and challenges of FDI flow in Nepal (Investment Policy review, 2012). Labor Law is also creating problem as it is hard

to fire the laborers after appointing them as workers in the project even though they do not work according to their work agreement.

### **6.3 Geopolitical Conditioning**

Geopolitics is a global geographical structuring. It is a location, land structure, bordering of a land which bears geographical, economic, social, cultural and political significance. It offers a very reliable guide of global landscape using geographical descriptions, metaphors, templates etc. It plays very important role in a countries foreign policy. Geopolitics and economic diplomacy are interlocked within as the world is longing towards economic liberalization at modern times. From the period of colonization to the postmodern liberal world geopolitics is playing significant role in economic diplomacy of the world's powerful countries (Dodds 2007).

Geopolitical conditioning has become one of the major challenges in the field of economic diplomacy of Nepal. The internal geopolitical conditioning is creating a problem in infrastructure development. The high mountain terrain towards the north have become barrier to promote trade to its northern neighbor. Being a landlocked country Nepal is completely dependent upon India for trade route and import of necessary raw materials for infrastructure development. Nepal lies between two Asian giants China and India. Both the countries are developing rapidly. Asia is going to lead the world economically in the near future especially India and China as together they are building sound economic relationship claiming that both the countries are working with same goal (The Economic Times, August 12, 2019). Land locked structure of the country is causing lots of constraints regarding economic diplomacy. Nepal shares extended border with India and not very less with China. Nepal's economic and trade policy cannot go beyond

consideration of its geopolitical situation. Being small state sandwiched between India and China Nepal is not free to form any economic policy practically though it is independent sovereign state. There are limited policy option for Nepal. Nepal can tactically go ahead in this difficult and sensitive geopolitical situation to attract FDI for economic prosperity (The Asian Times, 13 Nov, 2019). The neighbors are heading towards becoming game changer in world politics and economy. Nepal is always pressurized in the situation. Connectivity problem is always haunting Nepal. She has to build sound air connectivity, road connectivity, railways and transmission lines for the trade facilitation. Growing trade relation, border management and investment between China and India is creating some hope but more thoughts in Nepalese economic diplomacy but except India and China other investors are not confident to invest in Nepal because of its possible high costing to build connectivity required for energy trade to both the neighbors. China's mega project Belt and Road initiatives is going aggressively. Nepal can benefit in the sector of connectivity especially if proper diplomatic negotiation is done intercontinental transmission lines otherwise there will be huge gap in the field of infrastructure development due to the geopolitical constraints (The Rising Nepal, 29th March, 2020).

The future of Nepal's hydropower development is somehow dependent upon the policy and cooperation of India and China. They are the country with which Nepal has to trade energy. So, no policy can be made without their conscience. Either the case of long scandal of Arun Third or The West Seti project geopolitics silently played very significant role. The problem of Arun Third is solved when India agreed to invest in the project. West Seti is cancelled by China holding long time after getting done power

purchase Agreement. India's decision not to purchase energy from the hydro powers without Indian investment is also diplomatic decision of India to discourage the international investors. India is helping Nepal in building transmission system in Nepal and even cross-border transmission lines by opening a company in joint venture with Few Nepali companies. Power Transmission Company Limited is registered in 2007 for extension of transmission lines. India's Power Grid Corporation Limited has 20% share in the company. Dhalkebar-Muzaffapur 400 KV double circuit transmission line is built by the company (Hydro Nepal. July 2018). India is well aware about energy trade with Nepal and it does not want to let others to get benefit by selling energy to India which is geopolitically viable than to energy trade with China. This has become one of the striking challenges in economic diplomacy especially FDI generation in hydropower sector in Nepal.

#### **6.4 Diplomatic Negotiation**

Nepal possesses huge potential for energy trade. Many investors had realized that potential in different time in the history. World Bank, Asian Development Bank, different international companies have been showing interest in investing in Nepal but the result is not seen as it was expected. One of the reason behind decreasing interest of international investors is due to the lack of proper diplomatic negotiation. The past experiences are not favorable for the investors like WB, ADB, and even to Chinese Companies. When Arun Third was in controversy ADB waited for a long time hoping the country will solve the contradiction through negotiations different concerned group but it didn't happened. Rather the government silently supported the move of ADB for cancelling the project. The appeal made by the government was simply a customary approach (Mahat, 2005).



Diplomatic negotiation was not made properly to convince ADB and other investors to take the project ahead. Diplomatic Negotiation in the field has not been effective because Nepal lacks clear vision in economic diplomacy. Due to this there is not enough study, research and preparation in negotiation causing weak negotiation and ultimately diplomatic failure. Same thing happening in economic diplomacy especially in the generation of FDI in hydropower sector. Lacking exact definition, economic diplomacy has to do with the formulation and advancing the policy relating to investment in or other trading activities have not become effective. It is need to skilled person in government and private sectors for effective negotiation with knowledge, skill and mental strength (Institute of Foreign Affairs, 2012). Impact of ineffective diplomatic negotiation has been seen in many bilateral and multilateral project like Pancheswor Pariyojana, which is yet to activate properly due to lack of diplomatic negotiation. India has not fulfilled the promised of agreement yet no effort is made to take the project ahead in those 2 dozen years. West Seti and controversy is another example of incompetent negotiation where ADB at first and recently Chinese Company stepped back from the project (The Kathmandu Post, 29 March 2020). India's new decision not to purchase energy from Nepal from the projects without Indian investment is one of the discouraging factors for international investors. If India changes the policy international investors can revisit their investment policy that can generate more FDI in Nepal. Government of Nepal can influence India to revisit their policy regarding energy purchase but here also no effort of diplomatic negotiation seems to be made yet. Nepal can sit for negotiation on the ground of bilateral Power Trade Agreement-2014 signed by both the countries because the provisions of the agreement does not let India to make such policy in energy

trade (The Asian Review, Sep.20, 2019). But no effort is seen from the side of Nepal Government regarding the issue. One of the main reasons of failure of diplomatic negotiation is the conduct of politicians in the country. Politicians have hijacked the fundamental conduct of diplomacy ignoring the experts and professionals in the field. Rather than the experts political appointees are filled in the diplomatic missions who are neither any clear vision about diplomatic behavior not about national interest. Negotiation is always in the weak side for those exaggerated diplomats (Institute of Foreign Affairs, 2019). There is big question mark on relevance and effectiveness of diplomatic mission of economically poor countries like Nepal. Embassies are being accused for mere organization of parties rather than diplomatic efforts (Basyal, 2018). Effective diplomatic negotiation cannot be achieved in such context. All these examples are the evidence that how diplomatic negotiation is not coming up as per need and expectation for effective economic diplomacy especially in promoting FDI in hydropower in Nepal.

### **6.5 Political Instability and Issue of Security**

Nepal has been formulating different policies to attract international investors in the country. The first policy as an act was Foreign Policy and Technology Transfer Act 1992. The act opened the avenue to invest in Nepal by any international investors. Later with the change in sociopolitical situation new acts have been drafted time and again. After the establishment of Democratic Federal Republic Nepal, new policy has come into effect. Proposed Foreign Investment Policy, 2014 is an example of it. Every policy aimed at making national economy competitive and dynamic by maintaining trade balance through import substitution and export promotion attracting foreign capital and technology, skill and knowledge in national private sector (Nepal Energy Forum,

2014). Periodic Plans are giving high Priority in Generating Foreign Investment in the Country. Two investment Summits have been organized by the government still the achievement is less than expectation. According to the Global Opportunity Index there are four very special factors contributing to inflow FDI in any country in the world. They are; Economic fundamentals, Ease of doing business, Quality of regulations and Rule of Law (Foreign Policy and Regulatory Framework 2016, P.2). Nepal is somehow weak in those fundamentals of attracting FDI in the country. Though there are various claims that Nepal achieved political stability after Maoists coming to mainstream politics (Maskey and Dhungana, 2019). Nepal is going through political instability and long political and administrative transition causing very low economic development. Almost decade long political conflict in the form of Maoist Revolution is another responsible factor in the field of economic development in the country. Political instability always leads to policy uncertainty and ultimately insecurity in the field of FDI generation. Nepal's political situation became one of the major challenge in economic diplomacy in last few decades. Due to the frequent change in government and political power game, Nepal has been unable to pay attention in economic development especially in FDI generation in the country because it led to the political uncertainty and foreign investors always saw Nepal as suspicion place to invest that's why many investors cancelled the projects and went back to due to the insecurity (Asian Review, October 9, 2016). Internal political conflict has made many investors to rethink their investment planning. One of the examples of such conflict is Hauxin Narayani Cement where ruling party in Nepal were divided resulting the ill fate of the project (The Kathmandu Post, Nov7, 2019). Similar fate had faced by the huge hydropower Projects like; Arun Third Hydropower Project, West

SetiHydropower Project, Chovar Cement and many more. Political instability gives birth to uncertainty to policy making that makes foreign investors habitant to invest in Nepal. Furthermore the federal structure which is not structured properly yet is creating more fear to invest in Nepal (U.S. Department of State, 2019). FDI Generation has become a major political agenda in Nepal since 1990s but the result is not seen as per its buzz. It has rather become a political propaganda. Nepal is suffering from lack of preparedness and political stability. It has been difficult to attract FDI as there no international standard economic infrastructure. The policy also is not clear to guarantee the investor's security as it keeps changing with change in political system and even government.

## **CHAPTER-7**

### **CONCLUSION**

Hydropower development has become a prime economic interest in the context of Nepal. Since the first development plan, Government of Nepal has been giving most priority in this sector. Ample water resources has been the boon for the country but exploitation of it in progressive way is yet to be done. This has become a huge irony that having enormous potential in hydropower generation people are facing severe energy crisis in their living. Nepal has been buying energy from India where we have a plan to export in the future. The major problems in hydropower development is lack of capital and human resources. Government has been trying to attract foreign investment in the field since 1990s. In order to attract foreign investment Nepal drafted Foreign Investment and Technology Transfer Act in 1992 and with the change of time new acts have been implemented in the field. At present Foreign Investment and Technology Transfer Act, 2019 is launched. Government has organized three investment summits in twenty years' time. Still the situation is almost the same. Government has not been able to attract foreign investment to generate hydropower as per the expectation. The actual volume of FDI in hydropower is very low. That is the reason having tremendous prospect in hydropower generation Nepal is still facing energy crisis even in domestic use. The plan to export energy in neighboring countries for economic prosperity is yet the dream of horizon. It is true that Nepal's next door countries China and India are in rapid pace of economic development. For their industrialization both the countries need huge amount

of energy. Nepal can be the major exporter of energy in both the countries that can be boon for the country's economic prosperity. Nepal is facing investment problem in hydropower sector. The only way to develop hydropower sector is attracting FDI in the field. There are few obstacles like previous water sharing agreements between Nepal and India where Nepal could not gain upper hand due to the lack of proper research and poor diplomatic negotiation. The New Foreign Investment and Technology Transfer Act 2019 is launched by the government in 2019 with some changes in the provision prior to the Nepal Investment Summit 2019 and some other related acts like Labor Law, Special Economic Zone Act, Public Private Partnership Act 2019 are also in effect with the hope to attract FDI in the country but result is not as per the expectation. There are some fundamental reasons behind weak flow of FDI in Nepal. One of them is policy level challenge.

It is one of the major challenges of economic diplomacy especially in the field of FDI in hydropower sector. The research discovered that though the policies are made to encourage the foreign investors to invest in Nepal there are few provisions discouraging investment in the country. FITT Act 1992 had few problems that made FDI generation more challenging. Act prevented international investors to invest in the projects under 100 MW capacity that became one of the reasons of poor FDI flow in the country. International company could not get land ownership in Nepal causing less amount of FDI generation. Labor Law became another challenge for the FDI generation as work ethics has become an issue of Nepali workers in the different projects. Law could not prevent unnecessary strikes and even untimely demand of the workers in the work field. Labor migration and skill labor contract suffered from high costing. Nepal Investment Board

couldnot work as an independent sole entity in the field of decision-making due to the policy conflict with Nepal Electricity Board in the area of their jurisdictions. It has been facing political and bureaucratic interference time and again in its action and FDI related decision are not taken in timely manner to encourage foreign investment in the country. Policies are always keep changing creating perplexity to foreign investors. Supportive laws like Labor Law, Law related tariff and trade etc. are not revised in timely manner to guaranty the investment security and profit booking. Even the policies already made are not implemented properly.

Geographical conditioning is another challenge of FDI generation in hydropower sector. The land-locked structure and dependency to its neighbors for foreign trade is creating problem in smooth investment in Nepal by foreign investors. Trade Agreement between India and Nepal (2014) is also lacks proper implementation. India's simple objection can cause huge havoc in the energy trade which is not addressed seriously by the government. If India denies to purchase energy from Nepal it becomes very costly to trade energy in other countries even to China. It is difficult to build intercontinental transmission lines without India's and China's support and cost of building transmission lines is so high that the cost of production increases in huge amount and investors cannot afford to build it. Nepal's geographical conditioning has become a major challenge in FDI generation for energy trade.

Another obstacle of FDI in hydropower is human resource management. Lack of competent skill human resources at local level is another challenge in FDI generation because investors should pay huge amount for technical assistance and for consultants of the project. Weak economic infrastructures and unstable currency exchange rate is also

a challenge for investors to perform budgetary estimation. Nepal lacks energy bank to store energy for the crisis trade, which lowers the profits for investors.

Diplomatic negotiation is a striking challenge of economic diplomacy. Diplomats involved in negotiations are not well equipped with research knowledge and decision making capacity. They do not get sole authority to negotiate and reach to the conclusion. It is causing them inferiority complex and negotiation is done only customarily. In the case of FDI generation, diplomats are not been able to deal with international investors with decision making capacity.

Conflict between government and agitating force created security problem in different junctures of time. Political instability caused policy instability causing insecurity foreign investment. Maoist's insurgency added more challenges in the field of security. That made FDI generation poor in the decade of 2050s. Even the running projects faced numerous problem in project sites terrifying the investors. Even now political instability and security problem is haunting the international investors though Nepal has strong majority government formed in recent time. Unlike Dhungana and Maskey (2019) claim the political stability is not achieved in the country for proper environment of hydropower generation. Political transition is still going on. Policy level reform is still needed for success in FDI generation in hydropower sector.

In sum, Nepal has huge potential in hydropower development. FDI generation in hydropower is prime interest of Nepal's economic policy. But multifaceted challenges are ahead to address. Government should bring the change in hydropower policy. It should introduce investor's friendly and transparent policies. Labor Law, Taxation policy, trade and tariff policy needs to be reformed. Geopolitical constraints can be the boon for the



country if government deals both the neighbors in proper diplomatic manner as both of them are huge consumer of energy at present and even in the future. Corruption needs to be controlled in both policy and implementation level. Nepal Investment Board should be made autonomous and one window policy should be implemented strictly.

Jurisdiction between NIB and NEA should be made free from any overlapping. Work permits and residence permits should be less restrictive. Skill based education needed to provide to develop competent human resources. Equal treatment for public, private and foreign investors with easy procedure of licensing can be encouraging to investors. All the trade, tariff, currency exchange issues should be dealt with competent expert negotiators with full capacity of decision making. Most importantly India and China are the market with huge potential, very tactful diplomatic dealing is needed to drag FDI from those country in priority basis by which problem of energy trade, and market can be easily addressed in the days to come.

Economic diplomacy is not a periodic plan or programme. It is a part of the integrated foreign policy of Nepal. At this juncture, it is crucial to understand that economic diplomacy cannot succeed only with the effort of the government. The private sector must come up with innovative policies and enhance their competitiveness, so that the overall economy of the country can be directed towards the path of sustainable progress and prosperity (Pokhrel, 2020). Various factors are to be taken into consideration to foster Nepal's economic diplomacy

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