A COMPARATIVE STUDY OF CHINESE AND INDIAN INVESTMENT IN NEPAL AFTER 2008

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LETTER OF RECOMMENDATION

I certify that this dissertation entitled "A Comparative Study of Chinese and Indian Investment in Nepal after 2008" has been prepared by Sajina Rai under my supervision. I hereby recommend this dissertation for final examination by the research committee at the Department of International Relations and Diplomacy, Faculty of Humanities and Social Sciences, Tribhuvan University in the fulfillment of the requirements for MIRD 526 Thesis for the Master‟s Degree in International Relations and Diplomacy.

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Apeksha Shah

Date: July 11, 2022

DECLARATION

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APPROVAL SHEET

ABSTRACT

For developing nations, foreign direct investment (FDI) is crucial in promoting industrial growth and overall economy. FDI is viewed as significant source of inflow of capital, new technologies, and managerial skills. Nepal is one of the least developed countries with a large saving-investment gap and a low GDP. Nepal is located between two of the emerging economies of the world, India and China. India and China remain the top contributors of FDI in Nepal over the decade. This research aims to examine the total FDI made by China and India in Nepal after 2008. It also studies trend of investment in Nepal and attempts to identify major factors that motivate and affect the possible incoming FDI in Nepal. The author used both quantitative and qualitative research methodologies to get an answer to the research question. FDI data from India China in Nepal form the year 2008 to 2021 was analyzed. The study shows that in the last thirteen years China's FDI significantly grew while Indian FDI decreased in a staggering amount. In the year 2008 Chinese FDI was merely Rs. 231.3 million while India FDI was Rs. 3.6 billion. While coming to 2021 Chinese FDI stood as Rs 22.5 billion and Indian FDI stood at Rs. 726 million. The interaction between Nepal and China grew over the past decade however Nepal-India relations saw many ups and downs in the same period of time. Nepal offers tremendous amount opportunities of FDI. Nepal still has a long way to go before it can fully profit from its location between two economic powerhouses and exploit its potential.

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LIST OF ABBREVIATIONS

APEC	Asia-Pacific Economic Cooperation
ASEAN	Association of Southeast Asian Nations
BIMSTEC	Bay of Bengal Initiative for Multi-sectoral Technical and Economic Cooperation
BIPPA	Bilateral Investment Promotion and Protection Agreement
BRICS	Brazil, Russia, India, China and South Africa
DOI	Department of Industry
DTAA	Double Tax Avoidance Agreement
EMNE	Emerging Multinational Enterprises
EU	European Union
FDI	Foreign Direct Investment
FITTA	Foreign Investment and Technology Transfer Act
FPI	Foreign Portfolio Investment
FY	Fiscal Year
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
ICT	Information Communication Technology
IEA	Industrial Enterprise Act
IMF	International Monetary Fund
IO	International Organization
IPE	International Political Economy
LDC	Least Developed Country
MIGA	Multilateral Investment Guarantee Agency
MNC	Multinational Corporation

MNE	Multinational Enterprise
MOFA	Ministry of Foreign Affairs
NAFTA	North American Free Trade Area
OFDI	Outward Foreign Direct Investment
Rs.	Nepali Rupees
SAFTA	Agreement on South Asian Free Trade Area
SEZ	Special Economic Zone
SOE	State Owned Enterprise
TAR	Tibet autonomous region
TNC	Transnational Corporations
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
UN	United Nations
US	United States
WTO	World Trade Organization

CHAPTER I

INTRODUCTION

Nepal is one of the forty-six Least Developed Countries (LDC) in the world (UNCTAD, 2021). Despite being a small landlocked country, Nepal has presumed a strategic location in South Asia, bordering two of Asia's largest economies, China and India. The contrasts between Nepal and its neighbors are tremendously sharp. China and India are physically oversized to Nepal as China is 68 times larger and India is 23 times larger than Nepal (Kumar, 2017). According to the figures by World Bank, 2020, China's gross domestic product (GDP) stands at 14.72 trillion US$ and the GDP of India stands at 2.623 trillion US$, while Nepal’s GDP is merely 33.66 billion US$. At present, China remains the largest source of foreign direct investments (FDI) in Nepal followed by India.

Nepal and India have enjoyed close historical, geographical, cultural, religious, commercial, and economic ties (Jha, 2012). Similarly, the long-standing cultural and social ties between China and Nepal date to the middle of the seventh century A.D., which was established through Buddhism (Singh & Shah, 2016). The respective interest of China and India to engage economically with Nepal has been significantly influenced by the location of Nepal. The Chinese interests in Nepal seem clear because of Nepal's open border with India, they view it as a gateway to South Asia (Giri, 2017). However, Indian interest in Nepal seems to vary. According to many experts, Indian interests in Nepal include political, social, economic, and even regional ones. (Adhikary, n.d.).

Nepal witnessed a dramatic change in the political system in 2008. On May 28, 2008, the king was abolished and Nepal was declared a democratic republic by the elected assembly (Monk, 2008). This change also brought a dramatic shift in thinking toward the strategic importance of Nepal to India and China. India had a strong hold over the influence in Nepal but after the abolition of the Monarchy, the northern neighbor feared its security interest in Nepal and could be in danger in the absence of a reliable partner as the monarchy always remained a loyal partner to china following the two nations' establishing of diplomatic ties in 1955 (Bhattarai, 2018b). Therefore China was more eager to make a strong presence in Nepal than ever. Since 2008, FDI from China in the Himalayan state have been gradually surging mainly in the sectors like hydropower plants, cement factories, airports, telecommunication and other sectors (Ibid). It was clear that Indians had a monopoly on FDI in Nepal over the years; however, in 2014 China broke the Indian domination as the Chinese investment overtook India as the largest foreign investor in Nepal (Department of Industry, 2015). While the Chinese are making their presence strong in Nepal, Indian investment in Nepal is declining.

Chinese economic activities in Nepal have rapidly grown over the past decade, making India uncomfortable and seeing it as a threat to its own interest. India aims to limit Chinese influence because it sees Nepal within its traditional sphere of influence (Bhattarai, 2018a). However, China, for its part, recognizes Nepal’s sovereignty and has always followed the non-interference policy in Nepal’s domestic issues, which has garnered positive sentiment from the general public of Nepal. Despite having intense interest over Nepal, the Chinese and Indian investment in the Himalayan country is nominal compared to their investment in other similar countries like Nepal.

The main focus of the study is on Nepal's performance in attracting foreign direct investment (FDI), particularly from its neighbors India and China, after the country's adoption of a new democratic system. How these neighbors have channeled their strategic interest through economic activity. And also the areas of investments that Nepal can offer and challenges that Nepal need to overcome to create environment that encourages FDI.

1.1. Statement of Problem

FDI is an essential component of economic globalization and a lucrative opportunity for a developing country to boost its economy. Nepal is situated between two of the world's emerging economies China and India and these neighbors are the two largest FDI partners of Nepal. India had been the largest contributor of FDI until the first decade of 21^{st} century, however China began pouring direct investments into Nepal in the late 2000s in significant amount and surpassed India in the year 2014 as the highest contributor of FDI in Nepal (Department of Industry, 2015). It is very important to examine the amount of capital these two countries are investing in Nepal and its driving factors given that these are two of the world's economic leaders and have made huge amounts of overseas investments.

Nepal stands lowest in receiving foreign direct investment in South Asia. Being between India and China, Nepal is potentially attractive location for foreign investors. Nepal has huge amount of natural resources and has adopted liberal FDI policies that offer vibrant opportunity foreign investors. Yet, that is hardly being taken advantage of. Then the question arises of why Nepal is unable to attract investments to its potential. Though Nepal receives the highest amount of FDI from these neighbors, it is still minimal compared to other countries. Certain literatures have hinted that Chinese and Indian investments in Nepal are driven by their strategic interest rather than economic incentives. Therefore, the research can be helpful to analyze the direct investments made by China and India in Nepal, the opportunities that Nepal can offer and the hindrances repelling potential investors from both countries.

1.2. Research Questions

a) What has been the trend of Chinese and Indian investments in Nepal since 2008?

b) Why Nepal is struggling to attract FDI despite having huge potential and its proximity between economic giants India and China?

c) What are the opportunities and challenges of FDI in Nepal?

1.3. Research Objectives

a) To analyze the trends of Chinese and Indian investments in Nepal and their economic relevance.

b) To analyze the motivations behind their investments in Nepal.

c) To explore the opportunities and challenges of investment for Chinese and Indian investors in Nepal

1.4. Significance of Study

Given that Nepal is one of the least developed nations in South Asia, with low domestic savings, a lack of capital, and a dependence on foreign aid and grants for a large portion of its development expenditure, it is crucial to understand why Nepal is not making good progress on attracting the big amount of FDI. FDI promotes the creation of jobs and revenue, the transfer of technology, and helps in increasing foreign exchange. The key benefit is that it promotes the host country's overall economic growth, which domestic saving alone would not be able to do.

Although Nepal has abundant natural resources and is positioned between two of the world's emerging economies, it has not been able to fully realize it’s potential. However, India and China remain the top contributors to FDI in Nepal. So it is significant to study the dynamics and motivations guiding their investing decisions. It is also important to study the opportunities that Nepal can offer to foreign investors and the barriers that Nepal needs to overcome in order to attract more investments from these giants.

1.5. Limitations

This paper will study the patterns and amounts of Chinese and Indian investment FDI in Nepal after 2008 A.D. This study has certain limitations due to the broad area of study and the unavailability of financial resources. This study will cover the foreign direct investments made by China and India in Nepal from 2008 to till this date. On the other hand, it will also study the opportunities of FDI in Nepal and the challenges and barriers that the investors have been facing in Nepal. Therefore, this study will focus on the economic interrelationship between Nepal, India and China in terms of investment in Nepal and India and China’s motivations for investing in Nepal. It will not study the investment by other states except China and India and also other aspects of the economy like trade, financial aid, grants and assistance.

1.7.Chapter Organization

The research has been divided into seven chapters. Chapter I gives a brief background of Nepal and its relations with its neighbors India and China. It also briefly summarizes the dynamic and trend of their economic relations in terms of FDI. In Chapter II, an analysis of the relationship between liberal economic theory in international relations and practices has been formed and an examination of Nepal’s adaptation of liberal policies has been made. It also provides information about the situation of FDI in Nepal. Chapter IV examines the strategic relevance of Nepal, especially for India and China. Chapter V deals with this paper's core study: the comparative study of FDI from China and India after 2008 and the opportunities and challenges of FDI in Nepal. It examines the investment trend and pattern in Nepal from India and China.

CHAPTER II

REVIEW OF LITERATURE

2.1. The liberal economy: A theoretical outlook

Economic Liberalism is an ideology based on the principles of an individualist market economy, individual liberty, and private control of the means of production. It incorporates a variety of activities, including government policies that encourage free trade, deregulation, subsidy reduction, price restrictions and rationing systems, and, in some cases, the reducing or privatization of government services (Woodward, 1992). Since the late 1970s, economic liberalization has been at the core of adjustment policies implemented in developing nations, largely in setting lending terms imposed by international financial institutions (United Nations, 2010). As a result, the governments were suggested to follow policies of non-intervention or laissez-faire approach to depending on market forces for resource distribution (Ibid). It is considered that state intervention in the market will create impediments to its functioning and sometimes market failure. This approach will create economic stability, guarantee property rights and create a promising situation for the growth of domestic and foreign private sector investment.

In the political spectrum, liberalism takes protecting and enhancing the individual freedoms and rights and believes that government is to protect those freedoms and rights. It also acknowledges that sometimes the government can encroach on the political and civil rights of the individual. In general, liberals believe that the claims about the benefits of interdependence, free trade, collective security, and peace and harmony are the basic interests of the states (Sutch & Elias, 2007). Each liberal thought has a similar but distinctive version of liberalism. The classical liberals consider individuals as the core rather than the collective. They stressed that personal interest is the basic element of human nature, and each individual should have liberty from government regulations.

The classical liberal John Locke argued that ‘the law of nature (the moral law) exists before politics as it is given by God’ (cited in Sutch & Elias. 2007, p.66). By birth, God made every one of us equal, own natural rights free from any authority without our consent, and have the right to choose occupation or own property. Immanuel Kant also placed individual freedom at the core. He argued that each individual must be obliged to respect the independence of others. He also gives equal importance to the institutions of civil societies like clubs, societies and churches where people have voluntary membership, which will ensure social harmony (Butler, 2015).

Classical liberals support economic liberty in addition to social and political liberty. They argue that people should be able to freely invent, create, save, amass property, and trade with others. They also believe that economic liberty is the most effective means of achieving widespread wealth (Ibid). They believe that economic freedom allows people to respond spontaneously to each other's needs and collaborate for mutual gain and harmony (Princeton University, 2006).

According to them, open competition is the fundamental driver of mutual prosperity because when consumers have a variety of suppliers and products to select from, manufacturers are compelled to meet their needs as cost-effectively as possible (Butler, 2015). They also advocate that international trade should be just as free as the domestic economy.

The neo-liberal institution mainly focuses on two aspects of world politics; economic and social issues, and security issues termed as ‘low-politics’ and ‘high-politics’ respectively. To solve the issues in international politics, the liberals propose three major solutions: democracy, economic interdependence and international institutions (Gomichon, 2013).

The Neo-liberal school of thought proposes a political theory of international interdependence, describing the interaction between the state and non-state actors in a chaotic world of international politics (Sutch & Elias. 2007). They argue that the states that do not concern with economic cooperation are most likely to miss out on the benefits of cooperative opportunities. They affirm that economic interdependence like international trade integrates the states, as their interests become common.

They basically believe in long-term cooperation, common good, and ‘complex interdependence’ in world politics. Complex interdependence is as (Keohane & Nye, 1977, p.24) explain,

> *a world in which actors other than states participate directly in world politics, in which a clear hierarchy of issues does not exist and in which force is an ineffective instrument of policy*. (as cited in Sutch and Elias. 2007, p.72)

The theory of complex interdependence accentuates the development of transnational actors in relation to the state. The emphasis was given to the growth of international regimes and institutions that compensated for traditional military competencies, as well as the growing importance of welfare and exchange in foreign policy concerns as opposed to status and security issues (Mukand & Rodrik, 2019). Complex interdependence became a reliable lens for the neoliberals to study why the states are willing to cooperate beneath the setting of an anarchic system and dependence. This theory is considered to have anticipated what is now known as Globalization by highlighting the growing relevance of International Organizations (IOs) and Multinational Corporations (MNCs) (Ibid). They believed that globalization offers vast opportunities for development for several least developed countries and the developing countries as well.

Liberalism endorsed the notion that global institutions could represent roles and adopts accountabilities that states themselves were not able to implement. It was the mainstream idea of liberalism during the post-war era and projected that international cooperation could ensure global peace and security and the states could function better in coexistence. These principles were embodied through the establishment of the UN at the political level and its agencies Bretton Woods institutions and the General Agreement on Tariffs and Trade (GATT) at the economic level (Voutsa & Borovas, 2015).

2.1.1. International Institutions and Economic Interdependence

The very initial international institution the League of Nations was the brainchild of idealist thinker former US President Woodrow Wilson. It was conceived in the aftermath of the First World War, hoping to achieve collective security. Though it is considered a failure, it surely set the precedent for the formation of the United Nations aftermath the World War II ensuring the commitment of multilateralism with its membership of all the states around the world. The aim of the UN is not only to ensure peace and security but also to solve economic and social issues. In 1944, financial institutions such as the World Bank, and the International Monetary Fund (IMF) were founded alongside the UN (Sutch & Elias. 2007). These are collectively known as ‘Bretton Woods’ institutions. GATT was signed in 1947 by 23 states and was later established as the World Trade Organization (WTO) in 1994. These institutions were established to assist in restoring and sustaining the advantages of global assimilation through the promotion of global economic collaboration (IMF, 2002). Looking from a liberal perspective, these institutions have largely contributed to the formation of a multilateral framework of guidelines for international economic governance and play a significant role in making globalization function better.

By harmonizing its members' monetary policies and ensuring exchange stability, the IMF would provide a stable environment for international trade. It would also provide temporary financial support to its member states experiencing balance-of-payments challenges (IMF, 2019). On the contrary, the World Bank would help countries increase their trade capacity by lending money for rebuilding and development projects to war-torn and destitute countries. In general, the IMF emphasizes the regulation of the global monetary system and promotes comprehensive macroeconomic policies for sustainable economic development and the World Bank focuses on sustainable investment projects, institutional building and social, environmental and poverty concerns (IMF, 2002). The WTO was created partially to promote international trade and aid in the economic growth of developing nations. WTO is the sole international organization governing international trade ensuring the flow of trade is smooth, predictable and free as much as possible (WTO, 2021.).

The main aim of these international financial institutions is to propose the best structure of globalization for economic governance to achieve a win-win situation for the overall growth of the economy of all involved countries. It ensures the integration of domestic economies through the fair trade of commodities and services. A global capital market means greater rewards for success and also offers punishment for weaknesses. It provides new opportunities for all economies. Adoption of liberal economic policies such as open trade and free movement of capital offers a favorable investment environment for domestic as well as foreign investors in a particular country. Whereas, a complicated regulatory environment discourages new investments (The World Bank, 2018).

However, opportunities always come with certain risks. The policymakers need to manage the entailing risks accompanied by globalization and liberalization. The financial crisis of 2008/9 clearly demonstrates the risks associated with interconnected and interdependent global economies.

2.1.2. Regional Integration

In the last few decades, regional organizations have flourished around the globe and committed to regional integration. These organizations are often created to upgrade cooperation between the neighboring states within a particular region through agreements and rules. The main aim of these institutions is to integrate the region or collaborate to achieve certain goals like regional security, and economic prosperity. The states entering these agreements overcome certain trade and investment barriers that hinder the free flow of goods and services, and the flow of capital that they have against each other (The World Bank, 2019.).

Under the regional integration arrangements the people are able to work in other states, a common currency is formed, and even common political institutions are established and collaborated on regional security. Some of these organizations include certain developing countries to liberate trade and strengthen economic ties with developed states. The European Union (EU) is the best embodiment of a regional organization that exhibits the above-mentioned features. The Association of Southeast Asian Nations (ASEAN), Mercado Común del Sur, a trading zone between Brazil, Uruguay, Argentina, Venezuela and Paraguay (MERCOSUR) and the North American Free Trade Area (NAFTA) are some of the other well-established regional organizations (Robinson & Thierfelder, 2002)

Basically, the states entering regional integration requires to commit to collaborating in the following areas:

- Trade, investment and domestic regulation;
- Transport, ICT and energy infrastructure;
- Macroeconomic and financial policy;
- The provision of other common public goods (e.g. shared natural resources, security, education). (The World Bank, 2019, p.3)

Cooperation and collaboration in these mentioned areas are adopted by the regional organizations around the world and have assumed various forms of institutionalization with various ranges of policy obligations. A liberal economist would believe that these provisions provide new opportunities for substantial economic gains for the states through the creation of employment, transfer of skills and technology know-how, and access to a bigger market.

2.1.3. Globalization: MNCs in the form of FDI

Globalization is a term that describes the interconnectedness and expansion of technology, production, and communication around the world (Kyove et al., 2021). It is a process by which people are linked by wide intensive webs of relations transcending time and space. In the 90s, the term "globalization" began to appear frequently in academic publications on international political economy (IPE). On IPE, globalization is referred to as the process of increased economic integration through trade and flow of capital, movement of people and technology beyond their domestic borders (Osibanjo et al., 2014). Globalization can also be defined as an escalation in international interconnectedness or interdependence; however, its distinction from interdependence stems primarily from the central position of multinational corporations (MNCs) in the present international economy (Hart, 2016).

MNCs are one of several institutions that are involved in international business. Dunning and Lundan define MNCs, which are also known as multinational enterprises (MNEs) or transnational corporations (TNCs), as "an enterprise that engages in foreign direct investment (FDI) and owns or, in some way, controls value-added activities in more than one country" (2008, p. 3). An MNC has two distinguishing characteristics. It does two things: it connects, organizes, and harmonizes various real worth operations across domestic borders while also incorporating substantially several of the trans-boundary marketplaces for the intermediate products that come from these events. (Ibid). With FDI in manufacturing, services, or commodities, MNCs expand internationally with the aim of gaining partial or whole control over marketing, production, or other facilities in another economy (Gilpin & Gilpin, 2001). MNCs in the post-World War II period are more focused on manufacturing and services than on raw material and commodity extraction and rather than international portfolio investments, they are more likely to be financed by a combination of FDI and local capital (Dicken, 2015 and Gilpin, 1972, cited in Hart, 2016).

2.2. Foreign Direct Investment and Theories

2.2.1. Foreign Direct Investment

The Oxford dictionary defines investment as an act of putting money, time, effort etc. to make a profit or get an advantage. It is a conscious act made by an individual or an entity that involves the injection of money or assets on certain activity or production of goods and services intending to achieve target returns over a specific period. Investment models are either domestic or foreign investments like multinational enterprises (MNEs) or also called multinational corporations (MNCs), engaging in foreign investment. Foreign investment is any kind of investment that flows from one country to another. Individuals or entities have various possible ways of investing and holding assets in foreign countries. Foreign investments are particularly categorized into foreign portfolio investment (FPI) and foreign direct investment (FDI).

FPI is an equity investment in a foreign country without managerial control, whereas FDI is a direct investment in an entity with a specific level of control. Any foreign investment must meet the 10 percent voting share threshold referred to as FDI (Amadeo, 2021).

According to IMF "*FDI entity is defined as an incorporated or unincorporated enterprise in which a foreign investor owns 10 per cent or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise*" (2001, p.23).

World Bank defines FDI as "*net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor*" (2005, p.305).

According to UNCTAD (2019a, p.2) "*FDI is defined as an investment reflecting a lasting interest and control by a foreign direct investor, resident in one economy, in an enterprise resident in another economy (foreign affiliate)*".

Capital contributed to an enterprise by a foreign direct investor (directly or through other associated enterprises) or capital acquired by a foreign direct investor from an investing enterprise make up FDI flows (Ibid). FDIs are injected mainly through four ways founding a wholly-owned subsidiary or firm overseas, merging with another company or investor, forming an equity joint venture, and reinvestment of profit earned (Dangal, 2015). FDIs have a long-term interest in the host country with intention of expanding the business with profit returns.

FDI is not only beneficial to the investing party but also helps in the economic growth of the host country through creating employment opportunities, transfer of technologies and business processes, knowledge of export markets, and also may help in developing infrastructures social and physical. Normally, FDI is the transfer of assets or resources which may include financial capital, human resources, technology, skills and knowledge which may be perceived differently by the host country and the home country or the investor. However, both will agree that it is the shift of capital and control of substantial equity shareholders (Bajrami & Zeqiri, 2019).

The existence of FDI was in the primary area and to some level in manufacturing in the colonial regimes. However, the aftermath of the Second World War saw a tremendous growth of FDI as it grew twice the proportion of global output. In the 1950s and 1960s the US invested in rebuilding Europe and Transnational Corporations (TNCs) were the chief recipients (Dickens, 1998). Ever since FDI has been defined by various economics in different ways and the definition has changed over time.

2.2.2. Theories

Several theories were developed to analyze and describe the growing importance of foreign investment and MNCs in the 1950s and 60s especially the expansion of U.S MNCs into Europe. Many experts came up with overviews of FDI theories: for example, S. Hymer, Mundell, J. Dunning, R. Vernon. However, these theoretical explanations vary substantially; a unified theory is unlikely to be found.

In the beginning, prior to the 1960s, direct investments were considered as part of portfolio investment or just a shift of capital. However, portfolio investment theory was unable to explain the nature or characteristics of these kinds of investments. With the increasing trend of MNCs or direct investments, academicians tried to explain the acts of MNCs with theories of FDI (Rayome & Baker, p.4, 1995). Stephen Hymer was one of the first to come up with FDI theory with his dissertation in 1960 at the Massachusetts Institute of Technology distinguished direct investments with portfolio investments (Ibid). Before his work, direct investments were explained through neoclassical financial theory or portfolio investment flows. These theories say that the shift in the capital took place because of the higher interest rates. When there are no risks or uncertainties, capital flows are inclined toward the region with the possibility of the highest return (Nayak & Choudhury, 2014). On the other hand, Hymer asserted that direct investments tend to flow for other reasons than the interest rates.

The very common idea that attracting a greater deal of FDI can boost the economy of any country is supported by Caves; he says that the main reason that the countries make effort in attracting FDI from different other countries is due to the possible positive outcomes in the economy of the country (1996). FDI brings technology know-how, increases skills and productivity and increases international production networks. Some theorists even consider that FDI encourages competitiveness in local businesses. While Smarzynska (2002) discovered that local companies in Lithuania profited from spillover from serving overseas clients, Blomstrom (1994) found similar encouraging evidence in Mexico and Indonesia (as cited in Denisia, 2010).

On the other hand, some argue that FDI may be a threat to the local firms as the latter lack in various aspects. Hanson (2001) argues that there is very little evidence that FDI has positive effects on the economy of a country. He further argues that FDI tends to go to the highly productive countries and specifically to the highly productive industries of those countries, so it is unlikely that FDI promotes the competitiveness of domestic firms.

2.3. Nepal's Economy and FDI

Even though there are numerous prospects for greater growth rates through the development of prospective sectors of the economy such as agriculture, tourism, forestry, mining, and human resources, the Nepalese economy has been plagued by poor economic growth rates. Nepal is one of the poorest countries in the world, locked between two giants China and India with one-third of its population below the poverty line. About two-thirds of Nepal's population depends on agriculture but it only accounts for one-third of the total GDP of the country. The Nepali economy is reviving after a brief period of conflict and expanding at a rapid rate, making Nepal a high-risk, high-reward investment destination (Business Opportunity Profile-Nepal, 2013).

A report published by Nepal Rastra Bank (2021) shows that remittance is one of the key sources of the economy in Nepal contributing to 23.23% of the country’s GDP in the fiscal year 2019/20. The Economic Survey 2020/21 published by the Ministry of Finance shows that the service sector is estimated to have contributed 60.2% to the growth of GDP in the fiscal year 2020/21 followed by the agricultural sector with 20.2 % and the industrial sector with 19.6%. Nepal lacks the industrial dynamism necessary for rapid growth for economic development. Industrial sectors cover a minimal amount of its total GDP. Being a landlocked Himalayan country, infrastructure and transportation remain the main weakness of Nepal. Due to its poor physical connection with the neighboring countries it has limited access to the sea ports with which it can connect to the global value chain and develop the manufacturing sector. When it comes to the share of manufacturing activity in a country's GDP, Nepal ranks at the bottom.

A major reason behind the slow industrial development of Nepal can be attributed to the weakness of the country to attract bigger FDIs. Although the country’s performance is improving in terms of attracting FDI, Nepal still is one of the least FDI recipient countries in South Asia. However, according to Business Opportunity Profile- Nepal despite having a significant level of FDI flow, the manufacturing-based secondary sector contributes relatively less to GDP and employment creation (2013). Nepal is very rich in natural resources. The MNCs explore these resources to make benefit out of it, which will also benefit the host country. Nepal Investment Summit 2017 listed energy, infrastructure, manufacturing, agriculture, health, banking and financial sectors as top priority sectors of investment in Nepal.

2.3.1. History of FDI in Nepal

Nepal remained isolated from the outside world till the mid-20th Century both politically and economically. In 1956, Nepal established its first democracy, and the nation's first five-year plan marked the beginning of the country's strategic economic progress (Shrestha, 2010). It was limited democracy however; the country did end its isolation and opened up to foreigners. On contrary Nepal had historical ties with India and China. The new expansion of Nepal towards the international community had increased India and China’s interest in Nepal. Prior to that Nepal had several joint ventures with Indian businessmen and the county’s first production plant Biratnagar Jute Mill is a collaborative venture of Nepali and Indian entrepreneurs established in 1937 (Kharel, 2020). China has made major contributions to Nepal's development in areas including infrastructure building, industry establishment, education, health, and sports since the two countries' diplomatic ties were established (Kumar, 2011).

As the world saw a transformation in international economic structure Nepal also began to implement structural adjustment programs of the IMF and World Bank in the mid-1980s. Under the guidance of the World Bank and IMF, as early as the middle of the 1980s, Nepal adopted a neo-liberal policy that included privatization, a system of market-driven prices, trade liberalization, financial industry reform, fiscal amalgamation, and informal monetary policy mechanisms. (Shrestha, 2010). Similarly in the mid-80s, the foreign investment mode had a remarkable transformation. Midway through the 1980s, a revolution in global economic affairs took place as MNCs and FDI started to have a significant influence on practically all facets of the global economy (Gilpin & Gilpin, 2001). The carriers of foreign investment were the MNCs rather than the states themselves. Further, the post-Cold

War era witnessed a significant transformation of the global economy. Globalization has been the most notable feature of global economy since the end of the Cold War, and to a large extent, of political affairs as well (Ibid). Economic globalization has created economic integration and interdependence among the nation-states. Economic globalization according to UN refers how interdependent the world's economies are becoming due to the expansion of trans-border trade in goods and services, the movement of capital internationally, and the wide-spread and quick adoption of new technology (Shangquan, 2000).

Along with the change in the international political scenario Nepal also converted from a partyless to a multiparty system in 1990 (Kraemer, 1999). Then Nepal witnessed a gradual change in the policies regarding foreign investment and financial policies and acts. Nepal introduced Foreign Investment and Technology Transfer Act (FITTA) in 1992 which promotes foreign investment and technology transfer making the economy sustainable, vibrant and competitive. Similarly, Industrial Enterprise Act (IEA), which was also introduced in1992 and is also responsible for regulating and administrating FDI in Nepal. The Department of Industry (DOI) is the sole agency for the administration and implementation of these acts in Nepal (Department of Industry, n.d.). Since then Nepal has attracted FDI from different countries and India remains the dominant investor in Nepal. Starting from development assistance, Chinese and Indian investment in Nepal has expanded towards providing commercial loans and competing in the form of direct investment.

2.3.2. FDI Stock in Nepal

According to the DOI by the fiscal year 2020/21 (2077/78) a total number of 5,234 foreign investment ventures with projected foreign investment of Rs. 364.5

billion have been licensed from DOI generating 275,020 new employment. In the fiscal year 2020/21 alone a total of 118 industries have been registered by foreign investors with proposed foreign capital of Rs. 32 billion. China has the largest share of direct investment commitment with proposed foreign capital of Rs. 173.2 billion followed by India with Rs 98.6 billion of proposed foreign capital ((Department of Industry, 2021). It was a slight drop from the fiscal year 2019/20 when a total of 227 industries were registered by foreign investors with proposed foreign capital of Rs. 37.8 billion (Department of Industry, 2020).

FDI received by Nepal in 2019 was $185 million more than double of 2018(UNCTAD, 2020). . However FDI in Nepal was down by 32 percent to $126 million in 2020 mostly due to the halt in the tourism industry, one of the country's key industries (UNCTAD, 2021)

- **Industries approved for FDI by category/Sector**

The foreign investment in Nepal mainly focuses on eight sectors as presented in Tables 2.1 and 2.2 i.e. agro and forestry, energy, information technology, infrastructure, manufacturing, tourism, mineral, and service. Table 2.1 reveals that the largest amount of FDI approved by DOI in the fiscal year 2020/21 is in the tourism sector with a proposed foreign investment of Rs. 18,318.51 million followed by the service sector with Rs. 5,985 million, information technology with Rs. 3,005.13 million, manufacturing with Rs. 2,689.06, energy sector with Rs. 1,546.12 million and agro and forestry attracting Rs. 529 million.

Table 2.1. Industries approved for FDI by category/Sector (FY 2019/20)

Category	No. of Projects	Proposed Total Project Cost*	Proposed Total Fixed Cost*	Proposed Total Working Capital*	Proposed Total Amount of Foreign Investment*	Proposed Employment**
Agro and Forestry Based	3	560	351.2	208.8	529	145
Energy Based	4	19,542.45	19,344.76	197.69	1,546.12	242
Information Technology Based	16	1,380.00	951.22	428.78	3,005.13	680
Manufacturing	19	3,235.63	2,141.63	1,094.00	2,689.06	336
Service	41	6,185.00	3,290.30	2,894.70	5,985.00	1,826
Tourism	101	18,388.50	12,873.10	5,515.40	18,318.51	2,714
Total	184	**49,291.58**	**38,952.21**	**10,339.37**	**32,072.82**	**5,943**

*in million Nepali Rupees **in number

Source: Industrial Statistics, Department of Industry

Table 2.2 reveals that the energy sector has attracted the largest amount of foreign direct investment in Nepal till fiscal year 2020/21 with a total amount of Rs. 130,347.88 million. The service sector stands in second position with Rs 72,124.03 million followed by tourism, manufacturing, information technology, mineral, agro and forestry and infrastructure.

Table 2.2 Industries approved for FDI by category/Sector (up to FY 2020/21)

Category	**No. of Projects**	**Proposed Total Project Cost***	**Proposed Total Fixed Cost***	**Proposed Total Working Capital***	**Proposed Total Amount of Foreign Investment***	**Proposed Employment****
Agro and Forestry Based	291	9,409.82	7,580.34	1,829.48	7,588.23	10,524
Energy Based	90	222,832.30	218,727.21	6,005.09	130,347.88	11,837
Information Technology	112	14,595.48	12,232.85	2,362.62	11,367.38	5,745
Infrastructure	46	3,842.34	2,866.30	971.5	2,983.01	3,226
Manufacturing	1,212	122,548.10	95,241.78	26,444.36	61,063.16	103,091
Mineral	72	10,366.92	8,235.80	2,131.12	7,981.01	8,786
Service	1,722	96,570.98	59,835.66	36,589.64	72,124.03	73,162
Tourism	1,689	89,328.45	76,752.03	12,306.73	71,055.82	58,649
Total	**5,234**	**569,494.39**	**481,471.98**	**88,640.54**	**364,510.52**	**275,020**

*in million Nepali Rupees **in number

Source: Industrial Statistics, Department of Industry

- **Industries Approved for Foreign Investment by Scale**

According to the data of the Department of Industry, 184 foreign industries were registered in the year 2020/21. Amongst them, 172 are small scale industries and large and medium scale industries managed to get approval of only 6 industries each.

According to that same report, 227 foreign industries were registered; amongst them, 9 large scale industries, 64 were medium and 154 were small scale industries in the year 2019/20. The numbers are down by 32 percent in the following year, this might be the result of COVID 19.

Table 2.3 reveals that foreign investors are highly interested in investing in small scale industries. It displays the number of small scale industries approved in Nepal is more than 28 times than the number of large and medium scale. Table 2.4 shows that the number of small scale industries approved in Nepal is 13 times higher than the number of large scale industries and more than 8 times higher than the number of medium scale industries and a total number of 5,234 foreign investment projects with a proposed amount of Rs. 364.5 billion were registered till the fiscal year 2020/21 from the beginning. The details are presented in the following tables.

Table 2.3 Industries Approved for Foreign Investment by Scale (FY 2020/21)

Scale	**No. of Projects**	**Total Project Cost***	**Total Fixed Cost***	**Total Working Capital***	**Total Amount of Foreign Investment***	**No. Employment****
Large	6	24,472.45	23,411.36	1,061.09	7,678.96	376
Medium	6	1,300.00	1,077.80	222.2	1,039.86	312
Small	172	23,519.13	14,463.05	9,056.07	23,354.00	5,255
Total	**184**	**49,291.58**	**38,952.21**	**10,339.37**	**32,072.82**	**5,943**

*in million Nepali Rupees **in number

Source: Industrial Statistics, Department of Industry

Table 2.4 Industries Approved for Foreign Investment by Scale (Up to FY 2076/77)

Scale	No. of Projects	Proposed Total Project Cost*	Proposed Total Fixed Cost*	Proposed Total Working Capital*	Proposed Total Amount of Foreign Investment*	Proposed Employment**
Large	317	391,260.06	362,635.30	30,160.63	214,349.26	59,286
Medium	529	68,673.97	49,228.18	18,902.61	52,499.49	49,591
Small	4,388	109,560.35	69,608.50	39,577.31	97,661.78	166,143
Total	**5,234**	**569,494.39**	**481,471.98**	**88,640.54**	**364,510.52**	**275,020**

*in million Nepali Rupees **in number

Source: Industrial Statistics, Department of Industry

- **Industries Approved for Foreign Investment Country wise**

Table 2.5 shows that Mainland China made the highest amount of FDI in Nepal with a proposed foreign capital of Rs. 22.5 billion in the year 2020/21 followed by the British Virgin Islands with a proposed foreign capital of Rs. 3 billion. India stood in the sixth position with a proposed capital of Rs. 726 million. This is a staggering downfall of Indian investment approval from the former year as it stood at Rs. 3.8 billion (DOI, 2020).

Table 2.5 Industries Approved for Foreign Investment Country-wise (FY 2020/21)

Name of the Country	**No. of Projects**	**Total Project Cost***	**Total Fixed Cost***	**Total Working Capital***	**Total Amount of Foreign Investment***	**No. of Employment****
British Virgin Islands	1	3,000.00	2,710.00	290	3,000.00	146
China (Mainland)	140	22,345.00	13,897.12	8,447.88	22,502.20	4,506
China (Hong Kong)	1	9,105.00	9,060.29	44.71	1,276.07	136
India	9	1,120.00	620.2	499.8	726	380
Singapore	3	10,437.45	10,284.47	152.98	1,914.20	106
United States of America	7	1,880.00	1,315.88	564.12	1,678.94	140
Other Countries	23	1,404.13	1,064.25	339.88	975.41	529
Total	184	49,291.58	38,952.21	10,339.37	32,072.82	5,943

*in million Nepali Rupees **in number

Source: Industrial Statistics, Department of Industry

Table 2.6 shows that Mainland China has made the highest amount of investment in Nepal which amounts to Rs. 143.1 billion creating 80,994 new employments according to the Department of Industry accounting from the first day of registration to the year 2020/21. India has made the second highest investment in Nepal with Rs. 98.55 billion. The other countries making a significant amount of investment in Nepal are China (Hong Kong), the US, South Korea, the UK, the British Virgin Islands, Singapore, Mauritius, and United Arab Emirates.

Table 2.6 Industries Approved for Foreign Investment Country wise (up to FY 2020/21)

Name of the Country	**No. of Projects**	**Total Project Cost***	**Total Fixed Cost***	**Total Working Capital***	**Total Amount of Foreign Investment***	**No. of Employment****
British Virgin Islands	17	19,303.28	16,429.33	2,873.95	11,064.28	2,326
Canada	47	7,848.22	7,425.63	422.30	3,336.59	2,478
China (Mainland)	1,807	173,346.32	144,236.80	29,092.95	143,178.02	80,994
China (Hong Kong)	45	47,142.11	42,413.96	4,722.48	29,447.66	5,277
India	807	160,738.01	134,422.15	27,663.61	98,556.76	73,640
Mauritius	11	4,118.00	3,941.27	176.73	3,434.70	1,055
Singapore	55	20,769.27	19,666.10	1,088.18	6,481.59	3,659
South Korea	361	18,001.61	12,840.76	5,124.49	12,763.75	12,078
United Arab Emirates	23	6,552.46	3,544.78	2,957.67	3,760.57	1,877
United Kingdom	189	16,024.09	13,865.10	2,140.29	7,621.43	11,147
United States of America	424	28,619.38	25,494.77	2,874.56	14,970.95	18,958
Other Countries	1448	67031.64	57191.33	9,503.33	29,894.22	61,531
Total	5,234	569,494.39	481,471.98	88,640.54	364,510.52	275,020

*in million Nepali Rupees **in number

Source: Industrial Statistics, Department of Industry

2.4. Investment policies of Nepal

FDI flows in Nepal were noticeably accelerated during the 1990s averaging 8.3 USD annually against the figures of an annual average of 0.5 USD during the 1980s. The major factor can be attributed to liberal trade policies familiarized by Nepal in the 1990s (UNCTAD, 2003). Additionally, the formulation of a duty drawback scheme and the establishment of bonded warehouses helped to moderate the anti-export bias burdened by previous trade policies. The bilateral trade treaty of Nepal and India was inked in 1996, allowing India to import Nepali goods import duty-free and quantitative restrictions (except those on the negative list) which complemented the overall trade reform programmes made by Nepal (Ibid). Another significant factor was the liberalization of the exchange rate regime. In March 1992 the currency was made partially convertible in the current account and in February 1993 it was made fully convertible (Ibid). However, despite all these efforts on policy reforms the FDI inflow in Nepal remained minimal compared to other South Asian countries.

The Foreign Investment and Technology Transfer Act (FITTA) of 1992 liberalized the entry of FDI and assured the return of profit and capital; however, investors still faced many obstacles. For example, unusual inclusion of professional services on the negative list, which overtly includes management, accounting, engineering and legal services and ban on the founding of foreign travel agencies, dual screening of foreign technology and foreign loans, administration and business taxation policies, labour regulations etc (UNCTAD, 2003).

2.4.1. Regulatory Framework

According to World Bank Doing Business Report 2020, Nepal ranked 94 out of 190 economies in the ease of doing business making a significant transformation for the country into 100 economies around the globe (World Bank Group, 2020). The government of Nepal encourages foreigners to invest in Nepal both as 100% foreign-owned companies and as a joint venture with Nepalese investors (MOFA, n.d.). The constitution of Nepal guides the state policy to mobilize foreign capital and technology for the development of infrastructure in the sector of export promotion and import substitution as per the national interest (Article 51, D 10). Nepal has realized the importance of foreign investment for economic progress and simplified the investment procedures and also made some policy reforms in recent years. Prime Minister KP Sharma Oli led government has a motto 'Prosperous Nepal, Happy Nepali'. With a vision of graduating into a middle-income country from the least developed country, Nepal wants to achieve Sustainable Development Goals by 2030 (PM Oli at Envisioning Nepal 2030 Seminar, 2016).

Nepal has updated its Foreign Investment Policy in 2015 realizing the shortcomings of the policy of 1992. The main objective is to make the economy more dynamic and competitive by sustaining trade balance through the promotion of export and import management and drawing foreign capital, skills, technology and knowledge in the primary areas. In contrast to the old policy, the new policy incorporates shifting dynamics of portfolio investment, special economic zones, investment by non-resident Nepali, labor issues, and mobilization of debt instruments in domestic and foreign currencies. It also clearly outlines the terms 'foreign investment' and 'technology transfer' which were very unclear in the previous policy (Nepal Rastra Bank, 2018).

According to the policy, the institutions involved in implementing the foreign investment rules and policies in Nepal are the Investment Board, Ministry of Industry, Department of Industry, Foreign Investment Promotion Board, and One-Stop Service center. The policy provides the foreign investors with the provisions of access to foreign exchange and credit, facilities and exemptions, hiring foreign labor, land purchases, promotion of business and industrial security. It guarantees equal treatment, no risk of nationalization, and capital and profit return to the foreign investors.

2.4.2. Legal and Institutional Framework

Foreign Investment and Technology Transfer Act (FITTA), 1992 is one of the main arrangements that govern the FDI in Nepal which is now replaced by the new FITTA, 2019. Besides that, other arrangements that govern and facilitate the FDI in Nepal include Foreign Exchange (Regulation) Act, 1962, Investment Board Act, 2010 and Industrial Enterprises Act, 2016, Company Act, 2017, Investment Board Act, 2011, Contract Act, 2000, Arbitration Act, 1999, Income Tax Act, 2002, Labor Act, 2017, and Privatization Act, 1992. There are also additional acts specific to the sectors where the investment goes on. The acts include Electricity Act, 1992, Nepal Petroleum Act, 1983, Private Investment in Infrastructures Act, 2006, Mines and Mineral Resources Act, 1985, and Bank and Financial Institutions Act, 2017, among others (Nepal Rastra Bank, 2018)

The FITTA enacted in 2019 intends to reform the existing legal framework relating to foreign investment and technology transfer to achieve economic growth by making it competitive and employment-oriented through maximum utilization of available means and resources. It clearly defines the forms of foreign investment which are as follows:

1. Share investment in foreign currency,
2. Re-investment in an industry of dividends derived from foreign currency or shares,
3. Lease finance,
4. Investment made in venture capital fund,
5. Investment made in listed securities through secondary securities market,
6. Investment made by purchasing shares or assets of a company incorporated in Nepal,
7. Investment received through the banking channel after issuing securities in a foreign capital market by an industry or company incorporated in Nepal,
8. Investment made through technology transfer, or
9. Investment maintained by establishing and expanding the industry in Nepal. (FITTA, 2019)

According to FITTA, 2019, the Department of Industries and Investment Board act as the approval body for foreign investment in Nepal. In addition, they also provide a facilitator and regulatory services to foreign investors. The approval for foreign investment under Rs. 6 billion is given by the Department of Industries and foreign investment exceeding Rs. 6 billion is approved by the Investment Board under the Investment Board Act, 2011. After obtaining approval from the related approving body the foreign investor needs to submit the information along with a self-declaration letter to the effect that the source of funds is legitimate to the Nepal Rastra Bank (NRB). And NRB facilitates and regulates the foreign exchange arrangements (Ibid).

2.5. Conceptual Framework

According to the study, the theoretical foundations of the liberal ideas of economic interdependence are crucial for economic growth of all the included parties. Various literature suggest that one of the major components of economic interdependence is FDI. Well developed countries and MNCs and TNCs have increased their FDI in several poor as well as emerging markets, enabling them to grow at a faster rate. Conversely, some least developed countries have lagged behind and have not been able to grow as quickly. Prominent economists frequently support the free flow of capital across international borders since it enables the investments high rate of return. FDIs tend to go to the countries where there is high rate of incentives such as wage rates, skilled labors, policies, market, and natural resources. However, FDI has also become a strategic tool used by investing country to exert immense influence in the host country.

Least developed countries like Nepal seek attract these type of investments because the host country receive new technology, skill development trainings and foster competition within the domestic input market and contribute to the overall economic growth of the host country. So far India and China stands as the highest direct investors in Nepal. This study will focus upon the analysis of Chinese and Indian after 2008. The research took 2008 as the departing point because Nepal interred into a new phase of political system in that year. And the initial study shows that the Nepal-China engagement started more frequently after 2008 at all level. The emphasis has been put upon the dynamics of strategically motivated economic activities of China and India with Nepal. And finally it studies the factors affecting FDI in Nepal.

CHAPTER III

RESEARCH METHODOLOGY

3.1. Research Design

A combination of qualitative and quantitative research design has been employed in the course of this study as the subject deals with theoretical as well as numerical data. Different tables, graphs, and examples have been included in the various sections as needed in the context of the descriptive research design. As the relevance of FDI as the source of economic development increased in the second part of the 20th century, Nepal also adopted liberal policies in the 90s. However, Nepal has very low performance in attracting FDI among the Asian countries despite being immediate neighbors to the emerging giants India and China.

The qualitative methodology in the research topic has been centered on the phenomenon of globalization and economic interdependence and how Nepal has grasped the benefits of this phenomenon. On the other hand, the quantitative methodology deals with numerical data and analysis.

The first step of the research focused on the general concept of what it means to have a liberal economy, how it makes a way for foreign investment, and if Nepal was successful in doing so. It shows the scenario of the Nepali economy, policy frameworks and regulations and the status of FDI in Nepal.

The main study is then that of the comparison of FDI from China and India after 2008 in Nepal. It analyzes the trends and patterns of investments in Nepal from its neighbors. Exploring the interest behind the interaction also examines the present opportunities and challenges for FDI in Nepal.

The research has been supported by data collected through government sources, especially from the Department of Industries and Office of the Investment Board Nepal as well as literature produced by scholars and academic research institutions.

3. 2. Data Collection Methods

The information in the research is collected through a mixed process of content analysis. The relevant data has been collected through secondary sources such as government publications, peer-reviewed journals as well as magazines, reports, books, online archived data and newspapers and various websites. The provisions of foreign investment in Nepal have been reviewed using both published and unpublished pertinent literature. The main sources of statistical data were obtained from the official websites of Ministry of Finance, the Department of Industry, Nepal Rastra Bank, Office of the Investment Board Nepal, The World Bank, UNCTAD and other international organizations' publications were also used. As for the tables and graphs contained within the study, they have either been included as they were or were assembled through a thorough reading of a document and assessed according to the theoretical underpinnings.

3.3. Data Analysis method

Various pertinent data that were acquired from numerous sources have been assembled, summarized, evaluated, analyzed and presented in the form of tables and charts with the usage of tools like Microsoft Excel.

3.4. Limitations

Due to a lack of sufficient information, the study has a number of limitations. The paper focuses solely on the amount of FDI that China and India invested in Nepal after 2008. It analyses overall investments on a sector and scale basis, however due to resource limitations, it does not show sectorial and scale-wise investment from China and India after 2008. Additionally, the ownership of the FDIs whether private or state-owned is not examined. The accuracy of the results depends on how credible the secondary data's information is.

CHAPTER IV

NEPAL AND ITS STRATEGIC RELEVANCE

Geographical features of a state bring with them some challenges to avoid as well as some advantages and chances to reap the benefits. A state will be able to assure its survival if it learns to exploit its positioning to the fullest of its core interests. Any state's foreign policies are influenced by its permanent geographic location. Therefore Nepal's relations with other states are guided by its geographic location.

Nepal shares its northern border with the Tibet autonomous region (TAR) of China which stretches 1,414 km in length and shares an 1880 km long border with India on its south, east and west. Nepal shares an open and unregulated border with India which allows unrestricted interaction between the countries not only from the government to government level but also people to people level, economic and cultural. However, in the case of China, due to the high altitude configuration, cultural and economic interactions between the countries are very limited.

Nepal has garnered the attention of big powers since the beginning of the Maoist insurgency and the following political uncertainty. These states have shown keen interest in Nepali politics, interfering explicitly or implicitly with the country's political processes (Nayak, 2008). Since then Nepal's strategic feature has emerged for the big powers which pushed its immediate neighbors India and China to reconsider and redress their foreign policy toward Nepal. However, Nepal's strategic significance was not newly found.

Initially, the British recognized Nepal's strategic importance when it served as a buffer between British-controlled South Asia and Tibet, and then China while other major powers, such as the US, recognized Nepal's significance after China acquired Tibet. Nepal may serve as a buffer between communism and South Asia (Ibid). With the rise of China, Nepal’s position has become strategically more significant. Nepal has been increasingly embroiled in the rivalry between its two neighbors, India and China, in recent years.

4.1. Strategic relevance of Nepal for India and China

For India, Nepal holds a special position in its foreign policy due to centuries of physical, historical, cultural and economic ties. Their relation is shaped more by geography and history than by anything else. Nepal shares its border with four states of India, Uttarakhand, Uttar Pradesh, Bihar, West Bengal and Sikkim. As a result, India’s security perception in its northern region is in some aspects reliant on Nepal’s situation. There have been speculations that many anti-Indian activities are carried out through Nepal (Nayak, 2014). According to Murthy, the security concerns for the northern region of India do not directly rise from Nepal itself but from:

- the prospect that any state (particularly China) can easily access the mainland India through Nepal's northern border because the Nepal-India share an open and unregulated border
- Nepal, which is politically and economically unstable, would be particularly susceptible to such an occurrence, and the Indian mainland would be exposed as a result
- Nepal may pursue policies (both domestic and foreign) that are unfavorable to India's security interests (1999)

The geo-strategic significance of Nepal as defined by India was extension of British India's thinking in this regard, which had established treaty agreements with

Nepal (Ibid). As a result, Nepal and India signed a treaty of peace and friendship in 1950. The treaty, which is regarded as the cornerstone of Indo-Nepal relations, contains sections dealing with both security and economic issues.

For China, it has three major strategic interests; the first is containing Tibetan refugees and controlling their anti-China activities, the second is neutralizing India’s effect in Nepal and the third is investing in strategically important infrastructure projects (Nayak, 2008). Nepal serves as a geographical and cultural barrier between Tibet and Tibetan refugees in India for China. At least 20,000 Tibetan refugees reside in Nepal and by having a tight grip on Nepal China wants to control their movements and crackdown on these refugees. Traditionally China has adopted a pro-establishment policy toward Nepal with a diplomatic stance that it does not intervene or show too much interest in Nepal’s internal political concerns (Ibid). Withstanding the pro-establishment policy China opted out of the political struggle between the monarchy and pro-democracy parties in 1990 though King Birendra had sent a secret envoy to Beijing to secure Chinese help (Gokhale, 2021). China lost its dependable ally in 2008 with the collapse of the monarchy. Prior to 2008, China relied on the monarchy in Nepal to safeguard its fundamental security interests and its interactions with other parties were quite limited. China's foreign policy towards Nepal changed dramatically after 2008 as it was also very crucial for China to gain a foothold in Nepal.

4.2. Strategically motivated economic activities

Typically Chinese and Indian economic activities in Nepal are largely based on their sphere of influence over Nepal and their security concerns. Since India has traditional influence on Nepal and China has its own economy as well as security concerns, Beijing attempts to influence the Himalayan region. As Dabhade and Pant note, the strategic significance of Nepal lies in its proximity to Tibet and its position as a land barrier to China and India; ensuring Nepal's neutrality in the Tibet issue, checking the western influence and balancing the growing influence of India were major objectives of China in Nepal during the beginning of the 1950s and 60s and for India, Nepal remains the principal land barrier between China and itself (2004).

During the second half of the 20th Century, China and India had several face-offs and their influence over Nepal has seen ups and downs. In the late 70s and early 80s, India had modest success in having influence over Nepal through its economic aid and special economic arrangements. However, in mid-80s Nepal attempted to purchase military arms including anti-aircraft guns from China amid Indian objections which instigated an economic blockade from India (Ibid).To amend the relationship between Nepal and India the Trade and Transit Treaty was renegotiated in 1991 and India also set up an institutional mechanism to address various issues concerning Nepal including the 1950s Treaty of Peace and Friendship. Over the years India has made a tremendous effort to expand and uphold its influence over Nepal and at the same time to contain China from gaining a foothold in Nepal (Ibid).

On the contrary, Chinese interest in Nepal can be said to have shifted after 2008 as it is evident that Chinese investment surged in the Himalayan country in the late 2000s. It would not be wrong to say that India has lost the grip of its strategic space in Nepal to its counterpart China. China has been pleasing Nepal by engaging with its local partners through investments in the sectors like hydropower plants, cement industries, airports and several railway lines. Unlike India, China has a strong track record of implementing projects on time (Bhandari & Jindal, 2018).

Furthermore, Nepal made an agreement with China to join the global Belt and Road Initiative in 2017. Recent scholarly writings surrounding the accelerated Chinese economic engagement in Nepal along with other South Asian countries have two divisions of thoughts prevailing; some offer measured praise, while others supply sharp criticism. Minister of Foreign Affairs Pradeep Kumar Gyawali on his visit to China addressing a talk program on 'Nepal-China Relations and Development Prospects in Trans-Himalayan Region' at Sichuan University in Chengdu, welcomed the move and stated that it was a moment of pride for Nepal (MOFA, 2018)

On the other hand, some scholars are wary about the aggressiveness that China is showing today. They are claiming that the countries are falling into China's debt trap. The example in Sri Lanka, which has fallen into a massive debt trap by accepting Chinese-funded projects, illustrates how the Belt and Road Initiative could have negative economic implications for countries in South Asia (Chaudhury, 2017). According to Parker and Chefitz, China is lending developing nations billions of dollars usually which in return cannot pay back (2018). They intend to transform this economic loss into geopolitical gain.

India is concerned over the growing Chinese presence in Nepal and other neighboring states. India is set to combat aggressive Chinese investment in South Asia by increasing aid to its neighbors. India's aid to Nepal in 2017-18 stood at IRs. 375 Crore and IRs. 600 Crore is allocated for the financial year 2018-19 ("How India and China", 2018). It is clear that China and India have been competing for influence over Nepal through economic engagement. However, Nepal is yet to get real benefits from the willingness of its neighbors to invest in Nepal.

This study raises some potential issues. As previously stated the immediate neighbors of Nepal are economic giants and both have a strong interest in Nepal. But Nepal could never exploit the situation and attract investments to its potential from both countries in the past.

CHAPTER V

DATA ANALYSIS AND FINDINGS

5.1. Investments from China and India

Over the years, investors from different countries have made substantial investments in various sectors in Nepal. Amongst them, the immediate neighbors China and India dominate the list and have been contributing to the generation of income and employment opportunities. Nepal has received the highest amount of investment from China with a total amount of Rs. 143.18 billion followed by India with Rs. 98,56 billion (See Table 2.6) from the beginning to 15 July 2021.

India has been the largest FDI partner of Nepal until recently China took over. More than 150 Indian ventures are operating in Nepal accounting for over 30 percent of the total FDI of the country. These firms have been working mostly in all such areas as manufacturing, banking, insurance, education, telecom, power, tourism and other sectors. The most prominent Indian ventures in Nepal are Dabur, Hindustan Unilever, Asian Paints, Berger Paints, Kansai Nerolac Paints, Nepal SBI Bank, Everest Bank Ltd. (JV of Punjab National Bank, Gorkha Lahari, ITC, Life Insurance Corporation of India, Oriental Insurance, National Insurance, Tata projects etc (Jha, 2020). The official recorded FDI from India up to the fiscal year 1989/90 was Rs. 201.54 million, almost 50 percent of the total FDI received by Nepal till that year. India continued to be the largest investment partner of Nepal throughout the years with some occasional years when other countries like the US, Japan, and Hong Kong would top the list (DOI, 2021). However, the story has been different in recent years.

In 2014, India was overtaken by China as the number one investor in Nepal both in terms of the number of projects as well as in the total amount of investment.

So far there are two huge private investments from China Hongshi Cement and Huaxin Cement. These both are Chinese-Nepali joint ventures formed to establish cement factories in Nepal. The following tables and charts further describe the trends and patterns of FDI from China and India.

Table 5.1 Foreign Direct Investments in Nepal by China and India (FY 2007/08-2020/21)

Fiscal Year	**FDI from China***	**FDI from India***
2020/21	22,502.20	726
2019/20	25,582.65	3,897.09
2018/19**	46,506.94	5,098.81
2017/18	46506.94	5,098.81
2016/17	6,246.75	2,082.89
2015/16	6,211.81	1,941.91
2014/15	4,373.25	34,719.00
2013/14	7,314.44	6,540.83
2012/13	2,771.80	2,809.07
2011/12	986.03	2,298.00
2010/11	1,187.40	7,007.26
2009/10	715.75	3,993.54
2008/09	875.24	2,341.31
2007/08	231.3	3,645.40
Total	**172,012.50**	**82,199.92**

*in million Nepali Rupees

**Data are redundant as provided by the Department of Industry, Government of Nepal

Source: Department of Industry

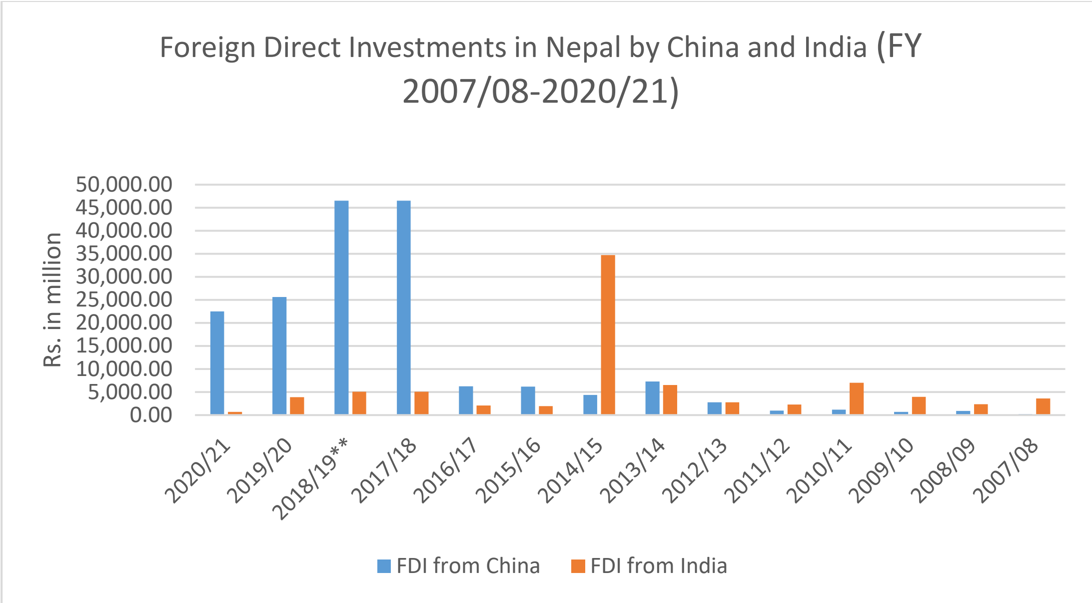

Figure 5.1

Table 5.1 shows the FDI in Nepal by India and China starting from the fiscal year 2007/08 up to the fiscal year 2020/21. It shows that in the last thirteen years China has made Rs. 172.01 billion of total FDI in Nepal. India on the other hand, has made a total amount of Rs. 82.19 billion of FDI in Nepal in the same period. At the start, the data clearly shows that the FDI from China increased steadily for three years. However, in the case of India FDI inflow takes a rather irregular path with subsequent decrease and increase. Interestingly, the FDI inflows from both nations decreased from the fiscal year 2010/11 to 2011/12, with the fall being more extreme in the case of India. The FDI from China is relatively constant starting from the year 2012/13 up to the fiscal year 2016/17 which is then followed by a massive surge of about seven times the previous year's FDI. The inflow of FDI from China remained constant for another year and then halved for the following two years. In the case of India, the FDI rose by about 5 times from the 2013/15 to 2014/15 followed by a drastic decline by a staggering 18 times lower than the previous year. The inflow grew steadily up to the year 2018/19 followed by a slight decrease.

Table 5.2 Sector-wise FDI from China and India (from the beginning to July 15 2021)

Country	**Category (sector)**	**No. of Projects**	**Total Project Cost***	**Total Fixed Cost***	**Total Working Capital***	**Total Amount of Foreign Investment***	**No. of Employment**
China (Mainland)	Agro and Forestry Based	109	5,271.90	4,692.11	579.79	4,970.68	4,001
	Energy Based	18	65,633.41	64,025.74	1,607.67	41,540.48	1,272
	Information Technology Based	56	7,041.92	5,444.39	1,597.53	7,033.07	3,486
	Infrastructure	10	578.21	435.91	142.3	547.13	641
	Manufacturing	310	17,817.26	12,913.07	4,887.62	13,847.67	20,139
	Mineral	49	5,005.10	4,045.14	959.96	4,994.10	6,092
	Service	560	30,844.75	20,003.37	10,841.37	29,605.09	24,741
	Tourism	695	41,153.77	32,677.07	8,476.70	40,639.80	20,622
	Total	**1807**	**173,346.32**	**144,236.80**	**29,092.95**	**143,178.02**	**80,994**
India	Agro and Forestry Based	13	1,203.41	557.18	646.23	739.71	919
	Energy Based	21	64,988.52	65,096.90	1,791.62	45,871.59	2,571
	Information Technology Based	9	198.74	152.15	46.59	188.94	307
	Infrastructure	17	2,246.19	1,614.33	631.86	1,876.32	830
	Manufacturing	421	53,593.96	38,770.32	14,482.92	28,266.65	43,198
	Mineral	19	4,790.62	3,888.76	901.86	2,470.77	2,248
	Service	223	24,417.93	16,144.84	8,204.03	14,511.44	17,101
	Tourism	84	9,298.65	8,197.67	958.51	4,631.33	6,466
	Total	**807**	**160,738.01**	**134,422.15**	**27,663.61**	**98,556.76**	**73,640**

*in million Nepali Rupees

Source: Department of Industry

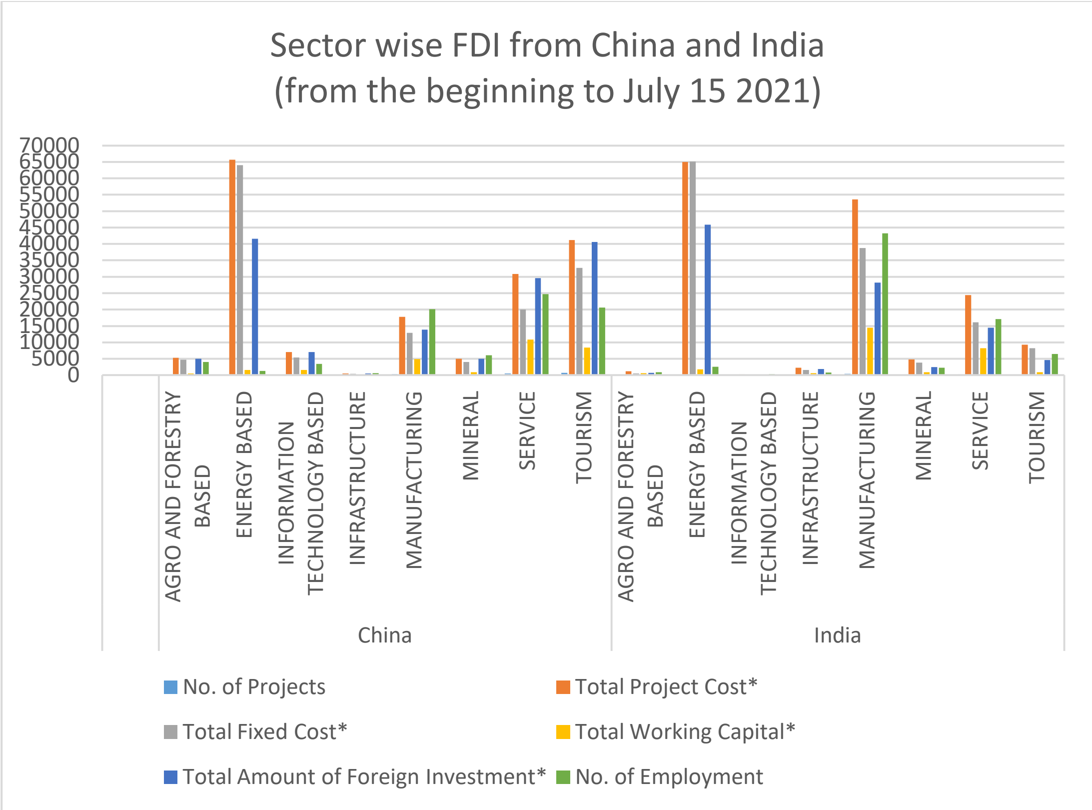

Figure 6.2

From the given data we can conclude that both China and India made a maximum investment in the energy sector in Nepal to date. The total number of projects invested by China in energy is 18 with a total amount of Rs. 41,540.48 million. In the case of India, the total amount of investment in energy is slightly higher than that of China, accounting for Rs. 45871.59 million. The energy sector trumped other industries in case of total fixed cost and total project cost in both countries.

In the case of China, it made the second largest investment in the tourism sector with Rs. 40,639.8 million. The service industry emerged as the sector providing the largest number of employment followed by the tourism industry generating 24,741 and 20,622 respectively. The manufacturing sector stood modest with a total investment of Rs. 13,847.67 million, totalling 300 projects providing 20,139 new employment. The infrastructure sector stood last with only 10 projects amounting to Rs. 547.13 million of investment creating 641 employments.

In contrast, India made the second largest investment in the manufacturing sector with a total amount of Rs. 28,266.65 million providing the highest number of employment adding to 43,198. Interestingly, although India itself is considered a powerhouse in information technology, it made the least amount of FDI in this sector across all fields only amounting to Rs. 188.94 million.

Table 5.3 Scale wise FDI from China and India (From the beginning to 15 July 2021)

Country	**Scale**	**No. of Projects**	**Total Project Cost***	**Total Fixed Cost***	**Total Working Capital***	**Total Amount of Foreign Investment***	**No. of Employment**
	Large	44	84,464.16	80,040.23	4,423.92	56,597.78	7,794
	Medium	211	29,395.25	24,617.46	4,777.78	27,914.81	15,536
China	Small	1,552	59,486.91	39,579.10	19,891.24	58,665.44	57,664
	Large	116	129,212.43	117,651.63	13,368.08	77,993.33	24,320
	Medium	146	14,067.47	8,908.92	4,953.20	8,339.93	17,571
India	Small	545	17,458.11	7,861.60	9,342.33	12,223.49	31,749

*in million Nepali Rupees

Source: Department Industry

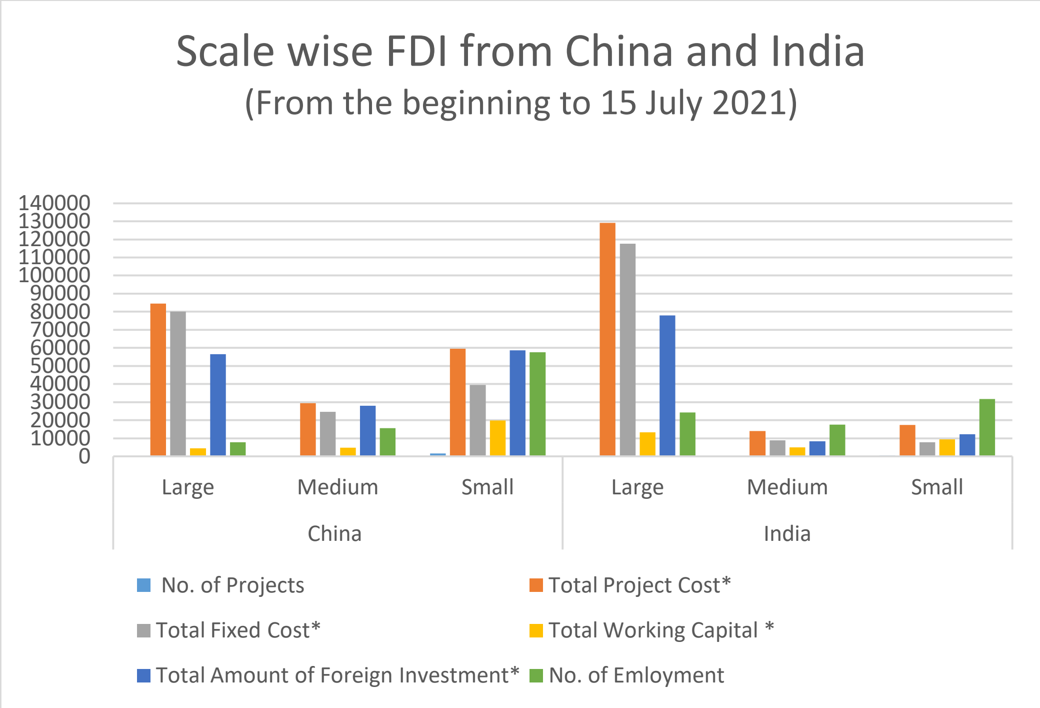

Figure 5.3

From the given data, we can interpret that China has made the highest amount of investment in the small scale industry projects followed by large scale and finally medium scale projects in the form of FDI in Nepal. However, the large scale projects carry the maximum total project cost followed by the small scale projects. The medium scale projects have the least amount of total project cost. The total fixed cost mirrors the same trend. Interestingly, the small scale projects carry the maximum amount of total working capital which is nearly 5 times more than that of medium and large scale projects. Similarly, the total number of projects is largest in small scale projects which are about 7 times more than the number of medium scale industries and 35 times more than the large scale projects. This trend continues in terms of the number of employment provided as well with the small scale projects clearly trumping the medium and large scale projects by a huge margin.

India on the other hand has invested in a similar number of large as well as medium scale projects in Nepal. The number of projects is substantially more in the case of small scale projects. The total project cost however tells a completely different story as the amount in the large scale projects is substantially more than that in the medium and small scale industries which both share similar figures. The total fixed cost mirrors the total project cost. In case of total working capital as well as the amount of foreign investment, the large scale projects remain at the top followed by small scale and medium scale projects. However, the number of employment provided by small scale projects is the maximum closely followed by the large scale and the medium scale projects.

Table 5.4 Total FDI from China (FY 2007/08-2020/21)

Fiscal Year	**No. of Projects**	**Total Project Cost***	**Total Fixed Cost***	**Total Working Capital***	**Total Amount of Foreign Investment ***	**No. of Employment**
2020/21	140	22,345.00	13,897.12	8,447.88	22,502.20	4,506
2019/20	176	25,900.70	19,914.24	5,986.46	25,582.65	8,946
2018/19**	160	49,027.00	47,198.03	1,828.97	46,506.94	6,369
2017/18	160	49,027.00	47,198.03	1,828.97	46,506.94	6,369
2016/17	183	6,743.51	5,585.74	1,157.77	6,246.75	5,487
2015/16	125	6,788.54	3,774.72	3,013.82	6,211.81	5,527
2014/15	154	4,868.66	4,049.70	818.95	4,373.25	5,908
2013/14	119	23,272.00	21,712.55	1,559.45	7314.44	4,618
2012/13	97	5,956.60	5,406.02	550.58	2,771.80	4,943
2011/12	77	1,009.53	814.62	194.91	986.03	3,326
2010/11	69	1,220.00	930.92	289.08	1,187.40	3,066
2009/10	58	731.25	558.62	172.63	715.75	2,791
2008/09	51	887.77	726.11	161.66	875.24	4,111
2007/08	15	248.8	183.75	65.05	231.3	731

*in million Nepali Rupees

**Data are redundant as provided by Department of Industry, Government of Nepal

Source: Department of Industry

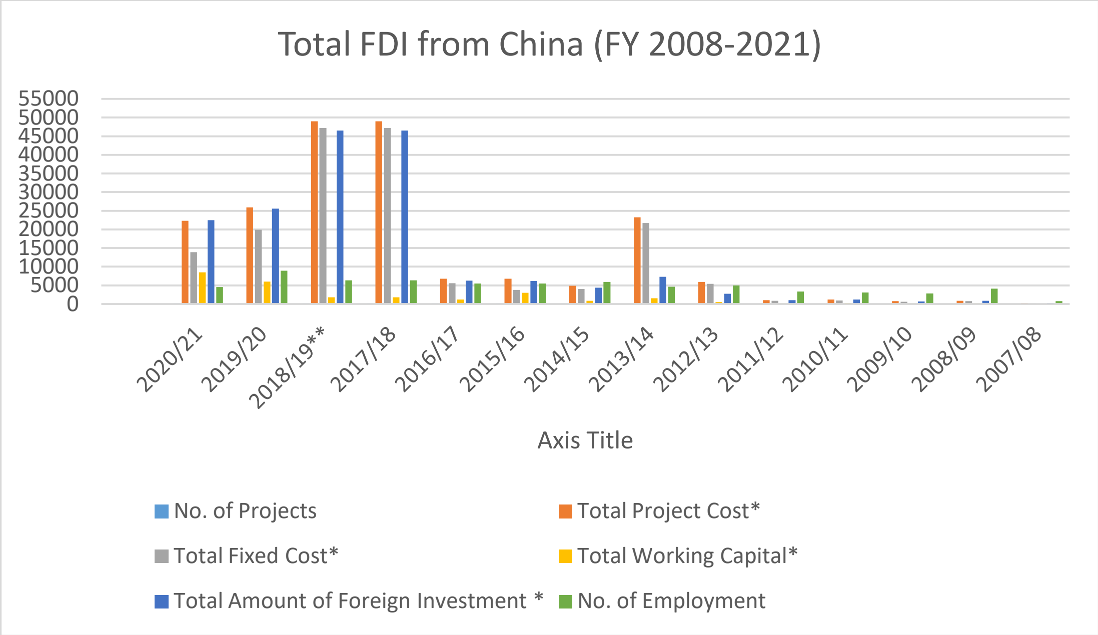

Figure 5.4

In the last thirteen years, FDI from China stood at Rs. 172,012.50 million with 1,584 total projects providing 66,698 employments. From the data provided, we can conclude that the FDI from China in Nepal took a very active path right after 2008. In the year 2008, the Chinese FDI in Nepal was measly RS. 231.3 million. In the meantime, the following year it increased by almost four folds amounting to Rs. 875.24 million. Then it went up steadily up to the year 2016/17. The amount of FDI increased drastically for the next year with Rs. 46,506.94 million. The FDI saw a decrease of almost half in the year 2019/2020 with Rs. 25,582.65 million and Rs. 22,502.20 million in the year 2020/21.

The total number of projects followed a similar path. The Chinese invested in 15 projects in the year 2008 and the following year they invested in a total of 51 projects. Then it saw a steady growth up to the fiscal year 2014/15. There was a decrease in the following year followed by an increase in the after year. Overall there was nothing on the extreme spectrum throughout the years in which data were taken.

The number of employment provided by Chinese FDI also took an extreme change in the first two years when it doubled by almost 5 times from 731 in 2007/08 to 4,111 in the year 2008/09. In later years it followed a similar path to the amount of FDI made.

Table 5.5 Total FDI from India (FY 2007/08-2020/21)

Fiscal Year	**No. of Projects**	**Total Project Cost***	**Total Fixed Cost***	**Total Working Capital***	**Total Amount of Foreign Investment***	**No. of Employment**
2020/21	9	1,120.00	620.2	499.8	726	380
2019/20	19	10,867.47	6,780.96	4,086.51	3,897.09	561
2018/19**	53	5,401.32	3,992.10	1,409.22	5,098.81	2,719
2017/18	53	5,401.32	3,992.10	1,409.22	5,098.81	2,719
2016/17	41	2,434.40	1,770.45	663.95	2,082.89	1,622
2015/16	23	2,339.70	954.2	1,385.50	1,941.91	764
2014/15	25	43,416.19	42,356.09	1,060.10	34,719.00	712
2013/14	22	8,378.69	7,785.84	592.85	6,540.83	2,108
2012/13	41	9,187.11	7,416.41	1,770.70	2,809.07	3,471
2011/12	24	3,887.82	3,485.03	402.79	2,298.00	1,754
2010/11	38	7,876.51	6,555.85	1,320.66	7,007.26	3,274
2009/10	27	7,789.53	7,372.05	417.48	3,993.54	1,835
2008/09	28	3,887.24	2,782.01	1,105.23	2,341.31	1,756
2007/08	29	5,179.84	3,915.70	1,264.14	3,645.40	2,569

*in million Nepali Rupees

**Data are redundant as provided by the Department of Industry Government of Nepal

Source: Department of Industry

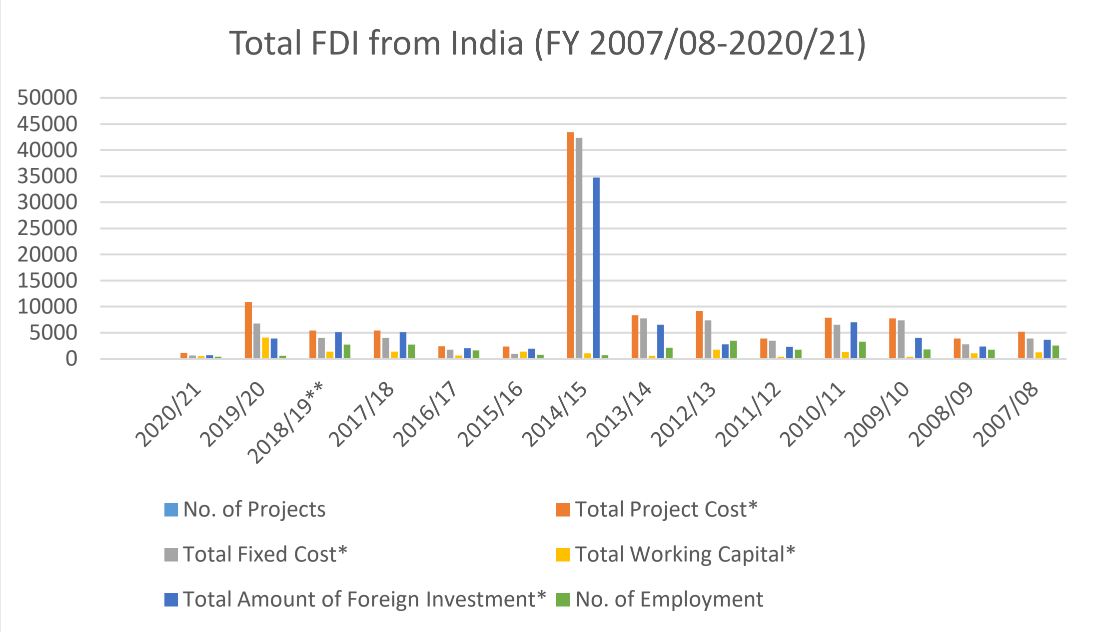

Figure 5.5

The data shows that, from India, Nepal received a total amount of Rs. 82,199.92 million of FDI in the last thirteen years. The Indian side invested in a total of 432 projects and provided 26,244 new employment. The data shows some inconsistency in the Indian FDI in Nepal. The amount of investment remains constant for the first three years. It was then followed by a sudden increase by more than double Rs. 3,993.54 million in 2009/10 to Rs. 7,007.26 million in the year 2010/11 followed by a steep fall to Rs. 2,298.00 million in 2011/12. The FDI follows a similar path during the whole period. In the fiscal year, 2014/15 the total amount of FDI Nepal received from India was Rs. 34,719.00 million. It was the highest amount in the last decade. It was again followed by a steep fall to only Rs. 1,941.91 million in the fiscal year 2015/16. The following three years showed steady growth and the FDI plunged to Rs. 3,897.09 million in the fiscal year 2019/20 and Rs. 726 million in the year 2020/21.

5.2. Economics and Influence: Chinese and Indian FDI in Nepal

Nepal-India relations reckoned as “special relation” have had their fair share of ups and downs throughout the time where India had tight grip over Nepal (Gokhale 2021). Nepal have maintained close relationship with India be it political, social or economic. India has used the economic ties with Nepal as a key tool to further its security interests. The very basis of Nepal India relations the Treaty of Peace and Friendship of 1950 has provisions that deal with both economic and security issues. Some of the key provisions of the treaty and letter state that the two nations will communicate with each other about any disagreements with neighbors that could lead to a deterioration in their cordial ties; they will refrain from hiring foreigners whose actions could endanger the security of either; and Nepal will only import weapons or other military supplies through the jurisdiction of India with the consent and assistance of India (Murthy, 1999). This particular clause has allowed India to maintain a tight hold on Nepal over the years.

Throughout the second half of the twentieth Century India had been closest partner of Nepal in every aspect of the bilateral relations between the states. India had been the largest investor in Nepal and had so-called big brother, patronizing attitude in Nepal due to the absence of any challenging forces in Nepal. Indian FDI had been significantly reduced over the last decade so as its influence has weakened significantly. Due to Nepal's blatantly reliance on India, there have been anti-Indian feeling among Nepalis, which has fueled the emergence of the pro-Chinese sentiments. The past recent years suggest that Nepal-India relations have been a rift in the bilateral ties between these two countries. The chills in the relations can be sensed ever since India's economic blockade to Nepal in 2015 which New Delhi denies

(Ojha, 2015). A severe thaw in bilateral relations was seen when Indian Defence Minister Rajnath Singh inaugurated an 80 KM road link to Kailash-Mansarovar in May 2020; Nepal raised objection over this, as this road passes through the territories Nepal Claims its own (Outlook, 2020). The Foreign Ministry of Nepal said it is a ‘unilateral act’ by India acted without resolving the ongoing border issues (2020). In addition, tariff and non-tariff barriers imposed by India have limited Nepal’s ability export.

China has challenged India's stance in recent years by leveraging on Nepal's dissatisfaction with India. Traditionally China has adopted a pro-establishment policy towards Nepal with a diplomatic stance that it does not intervene or show too much interest in Nepal’s internal political concerns (Nayak, 2008). Withstanding the pro-establishment policy China opted out of the political struggle between the monarchy and pro-democracy parties in 1990 though King Birendra had sent a secret envoy to Beijing to secure Chinese help (Gokhale, 2021). Prior to 2008, China relied on the monarchy in Nepal to safeguard its fundamental security interests and its interactions with other parties were quite limited. China's foreign policy towards Nepal changed dramatically after 2008. It was also very crucial for China to gain a foothold in as they needed a partner in Nepal therefore China began to ramp up its efforts to cultivate ties with the political parties and gain public sentiments through several economic activities including FDI.

Due to ideological connections, the Maoists in Nepal which came out as the largest party in Nepal in the Constituent Assembly election of 2008 looked at China with affection and strove to appease Chinese sensibilities through their speeches and actions (Ibid). Pushpa Kamal Dahal (Prachanda) the Chief of Maoist party rejected the idea of granting permission to reopen the office of the Dalai Lama's representative in Kathmandu and explicitly stated that his party will not 'condone any action that could displease China' (Sarkar, 2007). Prachanda became the first Nepali Prime Minister to visit China as his first foreign visit after holding the chair, breaking with custom in which most previous top leaders visited India first. While the Nepali Congress and Madhesi parties are typically considered pro-Indian these parties would keep good relations with China for some reasons like some leaders have economic interests in China, and their judgments are influenced by other interests (Thapliyal, 2021), and to gain public sympathy.

KP Sharma Oli then Prime Minister of Nepal and inked a historic Transit and Transportation Agreement with China during his visit to China in 2016. Subsequently in April 2019 Nepal and China signed the Protocol on implementing the Transit and Transportation Agreement, under which China agreed to grant Nepal access to its four sea ports and three land ports (Bhattarai, 2020). In theory, access to Chinese land and sea ports will assist Nepal in ending its entire reliance on India for third-country trade. In a joint statement with the China in 2018, Nepal formally reiterated its recognition of "One-China policy". In October 2019 Chinese President Xi Jinping paid a state visit to Nepal on President Bidya Devi Bhandari's friendly invitation. It is the first highest level from China to Nepal in more than two decades and a number of agreements were signed between Nepal and China. Prior to his visit the Communist Party of China (CCP) held a workshop in partnership with the Nepal Communist Party (NCP) to discuss Xi Jinping's Thought. The workshop was attended by KP Sharma Oli, Pushpa Kamal Dahal, Madhav Kumar Nepal and other senior leaders (Peoples's Review, 2019). Though these developments cannot be said the direct result of surge in Chinese FDI in Nepal, there have been claims that FDI played a big role in the progress of Nepal China relations (Balaji, 2021). The first Nepal Investment Summit was held in Kathmandu in 2017, and China pledged the largest amount of investment, totaling $8.3 billion, out of a total of $13.52 billion commitments. India claims that these pegged investments were made by the Chinese ahead of Nepal's provincial and interpreted as its attempt to influence and acquire political support in Nepal (WION, 2019).

5.3. Opportunities and Challenges FDI in Nepal

5.3.1. Opportunities of FDI in Nepal

The driving force for different MNCs to invest in any other host country can be identified as the size and the growth potential of markets as well as the strong institutions and investment-friendly regulations (Hornberger, Battat, & Kusek, 2011). Natural resources, as well as the lower wage workforce, can also be the factors that can attract FDIs in a country. Although the FDI trend in Nepal is poorer among the South Asian countries it has substantial opportunities for FDI and is willing to attract FDIs in numerous sectors. As the MOFA states, aiming to draw FDIs into the country, Nepal has been adopting a liberal foreign investment policy and working to build an investor-friendly environment (2017). Nepal has potential in different investment sectors like hydropower, industrial manufacturing, services, tourism, construction, agriculture, minerals and energy. Land, tourism, hydropower, Outsourcing from the US, Europe and Australia, and Medical tourism are the five major sectors of investment in Nepal as given by the Ministry of Foreign Affairs, Government of Nepal.

The opportunities can be divided into three groups:

- **Market:**

Nepal has a comparatively small market in South Asia however it is home to more than 29 million population. ADB (2010) found that, based on a survey from 2004, 23.36 percent of Nepal's population belonged to the middle and upper classes, spending a combined $10.72 billion annually in purchasing power parity (PPP) (cited in Adhikari, 2013). Due to its plenteous population and rising disposable incomes, rapid urbanization, and unexplored but expanding rural areas within the country the market itself is big enough for the survival of small and medium scale industries and fast moving consumer goods. But the larger investments need a larger market for profit return. Being a small country Nepali market is not limited within the boundary. Its strategic location between China and India gives easy access to markets of more than 2.7 billion people. It has an open and duty-free border with India and also has zero-tariff access to China for more than 8,000 products (Investment Board Nepal, 2021). Moreover, Nepali products have a larger scope of markets being a member state of various economic and trade related organizations and agreements like the Multilateral Investment Guarantee Agency (MIGA) of the World Bank Group and WTO, Agreement on South Asian Free Trade Area (SAFTA) and Bay of Bengal Initiative for Multi-sectoral Technical and Economic Cooperation (BIMSTEC). Nepal has duty-free, quota-free market access to the European Union (EU) under Everything But Arms (EBA) arrangements (Ibid). Since 2016 Nepal also has duty-free market access to the US for 66 types of garment items for 10 years (Investment Board Nepal and Ministry of Industry, 2016). In addition, Nepal has signed Bilateral Investment Promotion and Protection Agreement (BIPPA) with countries like Finland, France, the UK, Germany, and Mauritius and Double Tax Avoidance Agreement (DTAA) with eleven countries (Ibid). These market access prospects, on the other hand, have yet to be completely realized. As a result, FDI is in short supply to enhance production and productivity by taking advantage of market access advantages.

- **Policy Initiatives**

In Nepal, an intrinsic component of the Constitution fosters the role of the private sector and welcomes foreign capital and technology investment (Ibid). Aligning with the constitution, there are various policies and acts formed to protect the rights of investors and to promote FDI in Nepal. The liberalization of the exchange rate regime in 1993 allowed individuals and firms to open accounts in major convertible currencies with domestic banks after showing evidence of the source of foreign exchange (UNCTAD, 2003). In 1992 the Foreign Investment and Technology Transfer Act (FITTA) was enacted to stimulate foreign direct investments (FDIs) into the country which is now replaced by FITTA 2019 and it governs the FDI in Nepal. There are several other policies like Intellectual Property Policy - 2017, Foreign Investment Policy -2015, Industrial Enterprises Act 2016, Labor Act 2017, and Company Act 2017, enacted to protect the rights of the investors (Ministry of Industry, Commerce and Supplies, 2018). The Industrial Enterprises Act of 2020 has the “No work, no pay” provision which restricts illegal strikes.

Nepal is open for business in many areas allowing 100% investment in all industries except for the industries on the negative list, with progressive policies by the Government of Nepal to attract foreign investment and agencies such as the Department of Industry under the Ministry of Industry and Investment Board Nepal, which is headed by the Prime Minister himself, which has the responsibility of giving investors all the assistance they require.

- **Sector-wise opportunities for FDI in Nepal**

Energy

Hydroelectricity is the major source of energy that has the ability to fuel Nepal's economic progress. It has the potential to replace the expensive fossil fuels that the government is forced to buy at a high cost, saving billions of dollars. Nepal has abundant water resources which will give huge growth to the unused hydropower generation. The perpetual river systems Koshi, Gandaki, Mahakali and Karnali originate in the Himalayas and deliver snow-fed flows with high discharge even during the dry months. The medium rivers like the Babai, West Rapti, Bagmati, Kamala, Kankai and the Mechi are also perennial that can contribute to hydropower generation (Government of Nepal, Water and Energy Commission Secretariat, 2011).

According to the Nepal Investment Guide 2021 published by the Office of the Investment Board, Nepal has a vast potential for hydropower generation of 80,000 MW with an estimate of economically feasible generation of 42,000 MW and 1829 MWp of solar power. However, only 1458 MW has been installed and Nepal targets to produce 15,000 MW in the next 10 years. The Guide also suggests that USD 27 billion is needed to realize the targeted energy in the next 10 years.

The energy produced in Nepal can also cater to the growing energy demand of neighboring countries. In 2014 Nepal and India signed the Power Trade Agreement (PTA) which will give access to a large market for electricity export to India (SASEC, 2014). In addition, Nepal and Bangladesh inked an energy cooperation agreement in August 2018 where Bangladesh promised to import up to 9,000 MW of hydropower from Nepal by 2040 under this agreement (Bhattacharjee, 2021).

Nepal Investment Summit held in 2017 in Kathmandu has listed the energy sector as one of the top priority sectors of investment in Nepal. According to World Bank Data 2014, the electric power consumption of China per capita is 3144.377 kWh 15 therefore, China needs more energy in the future. To meet the demand, China can invest in the hydropower sector in Nepal and import energy from Nepal.

Transport

Only 19% of the roads in Nepal are all weather roads (IBN, n.d.). The National Planning Commission has identified twenty 'National Pride Projects' to enhance the development of the country's economy out of which ten are in the transportation infrastructure sector (National Planning Commission, 2015). The construction of mass public transportation infrastructure, including airports, railroads, monorails, and bus rapid transit (BRT), has been prioritized to meet the demands of the expanding population (Investment Board Nepal, n.d.). The Chinese and Indian investors can explore this sector and build a public-private partnership.

Tourism

Tourism is one of the major industries in Nepal. Nepal is gifted with an attractive landscape and cultural diversity. It has enormous opportunities for tourism industries with its popularity amongst mountaineers, trekkers and adventure seekers. Nepal has various mountain ranges including the world's highest mountain Mt. Everest. With the presence of beautiful lakes, steep rivers and gorges, unique wildlife, historic monuments, impressive fine arts, significant religious sites and exotic cultures wide range of tourists are attracted. There is also a prospect of religious tourism and pilgrimage in Nepal. The birthplace of Lord Buddha, Lumbini and Pashupathinath are the main sites for attracting people (Investment Board Nepal and Ministry of Industry, 2016). In the year 2014, almost 800,000 tourists visited Nepal. The number of tourists slightly declined in the year 2015 due to massive earthquakes but the number increased from 554,747 in 2015 to 729,550 in 2016. 104,005 Chinese tourists visited Nepal in 2015. Nearly 200,000 Chinese tourists visited Nepal in 2019 (Tan, 2021) while around 209,611 Indian tourists visited Nepal in the same year (The Wire, 2021).

There is a wide range of opportunities for Chinese investors to invest in the tourism sector in Nepal. The tourism industry is a private sector-driven industry therefore it can be an attractive area to invest in. It can be divided into two segments. One side of investment can be in capital-intensive infrastructures like roads and airports and others can be service-oriented businesses like hotels, restaurants, tea and coffee shops, adventure-oriented services etc.

Information Communication Technology (ICT)

Information and communication technology (ICT) is one of Nepal's fastest-growing industries. Except for the media, all services related to the ICT industry are available to foreign direct investment and in telecommunications 80 percent foreign ownership is allowed in Nepal (Investment Board Nepal and Ministry of Industry Nepal, 2016). Business process outsourcing (BPO), Software Development, Internet Service Provider, Artificial Intelligence, Robotics, and Animation are the major fields of ICT identified by the Investment Board Nepal for FDI. In addition, E-commerce in Nepal is one of the growing businesses therefore, investors can tap the opportunity.

Mines and Minerals

Mining was one of the prominent investment sectors emphasized in Nepal Investment Summit 2017 which was held in Kathmandu Nepal on March 2-3, 2017.

The Nepal Investment Guide 2021, lists metallic minerals, gemstones, non-metallic minerals, decorative stones, and construction minerals as opportunities for investment in the mines and minerals sector in Nepal. According to the report, 2 billion metric tons of dolomite exist in Nepal and have the potential of an estimated 88,000 tons of copper deposits and 200 million tons of high-grade magnesite.

Health and Education

Health and education are the most prominent factors of development. Nepal has the advantage of traditional Ayurvedic medicine and a moderate climate. Nepal has abundant medicinal herbs and natural resources. The most attractive investment opportunities comprise tertiary hospitals and pharmaceutical manufacturers and the government of Nepal is supportive of foreign investment in this sector.

In terms of education, although there has been development in the education system in Nepal, a lot still can be done. Lack of quality in the education system can be seen as thousands of students going abroad and spending millions of money to gain a good education. Investors can invest in developing education and infrastructure.

Manufacturing

In Nepal, both large-scale and small-scale projects have great prospects in the manufacturing sector. The government of Nepal has allocated various Industrial Districts and Special Economic Zones to promote investment in the manufacturing sector by ensuring an investment friendly environment and hassle-free administrative process. The areas of investment promoted by the government of Nepal are fast-moving consumer goods (FMCGs), garments, pharmaceuticals, cement, metal and metal products (Investment Board Nepal, n.d.).

Agriculture

Nepal's economy is majorly based on agriculture. The Nepali government has announced plans to multiply agricultural productivity in the next five years by modernizing, diversifying, commercializing, and marketing the sector. Therefore as of January 2021, the government revised its negative list to enable foreign investment in agriculture (UNCTAD, 2021). Nepal encourages investments in input markets such as the fertilizer industry, tools and technology seeds, nurseries, and also agricultural financing (Investment Board Nepal, 2021). There are only a few small producers at this time, and they lack market knowledge as well as the technical and financial capabilities to take advantage of the opportunities that have been made accessible.

5.3.2. Challenges

While it is normal for LDCs and post-conflict countries to experience difficulties luring and keeping investors, Nepal confronts several particular issues that are neither typical nor adequately addressed by any theory (Adhikari, 2013). Nepal seriously needs FDI for its economic growth and other objectives of the government like poverty alleviation, education and health. However, the lingering political issues have overshadowed the economic issues for decades. As a result, the investment climate has not improved much. Nepal has not been able to attract an ample amount of FDIs also it is not able to execute the total commitments into the actual inflow. There have been millions of dollars' worth of FDI pledges in Nepal but the actual FDI inflow remains very poor. Nepal received FDI pledges worth Rs15.13 billion in 2015-16, but the actual investment amounted to just Rs. 4.79 billion as of the 11th month of the fiscal year (Subedi, 2016). A Survey Report on Foreign Direct Investment 2018/19 by Nepal Rastra Bank shows that the total amount of actual realized FDI accounts for a meager 34.1% of the total pledged amount between 1995/96 and 1920/20. There is range of reasons that hinders leveraging investments in Nepal. Some of the major challenges are related to political, legal, institutional, policies, infrastructure and resources:

- **Political and governance related**

Political instability has been the major factor restraining the investment climate in Nepal. The World Bank Group Enterprise Surveys report 2013 indicates that political instability accounting for 48.9% is the most highlighted obstacle for business owners in Nepal. The prolonged political shift has discouraged Nepali as well as overseas investors from investing in Nepal due to insecurity. This feeling has become prevalent; mainly Nepal took too long to write a new constitution finally drafted by Second Constituent Assembly in 2015.

The frequent changes in government in Nepal have severely impeded the country's environment for investors. Corruption which includes bribery, donation and extortions have raised the risks of doing business in Nepal. According to the World Bank (2013), the bribery depth percentage of public transactions where a gift or unofficial payment was demanded is 10.9% and the percentage of the firms identifying corruption as a chief restraint is 44.7%. The court system is also considered an obstacle for investors. According to the same research, 17.9 percent of firms recognize the court system as a major constraint in doing business (Adhikari, 2013).

Changing policies with the change of the government has become a norm in Nepal, this is the main concern of the investors. Large projects are especially affected by this where much longer time is needed to complete and execute the project. It was thought that Nepal became politically stable after the election of 2018, the instability still looms in the country after the PM Oli led government was toppled in the year 2021. It is uncertain whether this kind of event will not take place in the future.

- **Legal, institutional and policies related**

Despite the flexible legal system the fragile condition of FDI inflow in Nepal can collectively be attributed to various factors. Multiple overlapping and frequently incompatible laws and institutional frameworks, variable agendas of different government agencies, and significant gaps between policies and their actual execution are all to blame for Nepal's unfavorable investment climate (Dangal, 2015). Nepal has many policy inconsistencies that were responsible for many foreign investors coming into Nepal and existing investors pulling out their investment from Nepal (Nepal, 2021). Another very common problem is acquiring a visa. The visa granted by the government of Nepal is not adequate for investors. Non-tourist visa for expatriate staff is granted for one year and on the recommendation of IBN/DOI and the Department of Labour can be extended for 5 years on an annual renewal basis. Similarly, a business visa is granted for periods not exceeding five years and may be extended and the validity of the residential visa is one year at a time (Investment Board Nepal and Ministry of Industry, 2016).

In Nepal, the need for EPZs has not been realized though it is one of the factors attracting foreign investors. Nepal has not made any provisions regarding the losses of enterprises during the labor strikes in the company. Due to the rigid Labor Act the firms have difficulties in dealing with the Nepali Trade Unions. The FITTA has improved the investment environment in Nepal, there are many constraints which still need to be explored and revised. Some of them are as followed:

Lengthy Approval Process: The one-step service center was envisioned in the Industrial Enterprise Act of 2016 but only introduced by the FITTA 2019. According to the Department of Industry, this center will give services to firms or industries with capital above Rs 100 million and foreign direct investments up to Rs 6 billion and the Investment Board of Nepal will handle investments worth more than Rs 6 billion. However, this provision has not been fully implemented therefore investors are obligated to visit different ministries and departments for the investment procedure which makes the processing time-consuming and costly (Shrestha, 2022).

Limits on Foreign Borrowing: The central bank of Nepal has set the limit of LIBOR at +5.5% on interest rates to the foreign lenders in all sectors (The World Bank, 2018). This might be a key obstacle for certain sectors. Furthermore, if there are outstanding debts to foreign banks, the central bank does not allow the settlement of foreign borrowings (Ibid).

This could make foreign lenders wary of lending capital in Nepal since they see it as a high-risk investment. Due to the interest rate cap, foreign lenders are unable to raise interest rates to compensate for such risks. As a result, Nepal may not be very suitable for receiving foreign investment in the form of debt.

Copyright laws: Nepal’s Copyright Act is below the standard of international intellectual property rights. There have been many instances in that MNCs have filed cases of trademark infringement with little to no action from the authority. Patents are not recognized by Nepal, therefore new MNCs are discouraged to enter Nepal.

The minimum threshold for foreign investment

The minimum threshold for FDI in Nepal was Rs.50 million as of 2022 (UNCTAD, 2019b). It was a threshold for all industries. It can act as a repelling factor for small scale industries, for example, software companies. In addition, according to a new regulation issued under FITTA in January 2021 foreign investors must now bring in 70% of their intended investment before starting operations, with the remaining 30% coming in over the next two years and They must also transfer the capital they have pledged within one year of the project's approval (UNCTAD, 2021). However, the government announced to reduce the minimum threshold by 60% to Rs. 20 million while presenting the annual budget for the fiscal year 2022-23. Eventually, the government's action might improve Nepal's FDI environment.

In Nepal problems related to policies have two sides. The first is that policy inconsistency in the country and on the other side, the formulated policies are not implemented on the real ground. The ever-changing government of Nepal makes it hard to implement the formulated policies and also sometimes the public officials opt not to implement them because they do not have the capacity to implement them.

- **Infrastructure related**

The infrastructures of a country like the transportation system, energy, and port facilities can seriously affect the investment environment. Nepal experienced a persistent lack of energy supplies for more than ten years, from 2006 to 2017. In a situation where the government could not supply the electricity according to the demands of its citizens, there was no way out it could supply an adequate amount of electricity for the heavy industries. The problem of power supply seems to be ending but this is a long-term problem, therefore, Nepal needs to focus on alternative energy sources. However, the fuel price is very expensive in Nepal and in addition, Nepal Oil Corporation (NOC) has a monopoly over the supply of the fuel. There are several instances in that NOC has been incapable of supplying the fuels. The industries cannot function in a place where there is a shortage of all means of energy.

Only 12305 kilometres (42.20%) of the 29157 kilometres of usable road network in Nepal are black-topped, and the state of the road is terrible because there are no effective and consistent repair and maintenance (Bhagat, 2017). Given that land transport accounts for the majority of imports and exports in Nepal, the importance of road transportation cannot be overstated. Nepal heavily depends on the Kolkata port in India for handling its all sea freight. The investors need assurance of export of their manufactured goods. But being a landlocked country Nepal only can offer limited seaports to connect with the global market.

- **Resource related**

Nepal has abundant natural resources that can make it an attractive destination for investment. However, it also has various challenges concerning resources. This category focuses on three major problems: human resources, financial resources and technological resources.

Human resources

The problem in human resources can be analyzed at different levels in the context of Nepal. Though it has more than 29 million populations it does not have highly educated human resources with the skills required to be employed in the industrial and service sector. The educated people are going abroad for a brighter future. This is justified by the fact that Nepal is a victim of brain drain. The people with lower education and skills migrate to the Middle East and South East Asian countries like Malaysia in search of employment. Those who have been left behind are largely unionized, and they are prone to seek more compensation and benefits without increasing their productivity (Adhikari, 2013). The constitution and statutes of Nepal give workers the freedom to establish a union (Investment board Nepal, 2016). Sometimes they are motivated by political agendas and work as an agent of political parties rather than an efficient employee motivated towards the enhancement of productivity.

Financial resources

Usually, MNCs don’t need financial resources in the host countries because they are considered rich and the whole point of investing abroad is to use excess fund to enter international markets and take advantage of the host nation's comparative advantage. Therefore financial resources can be a minor barrier for foreign investors to investing in a host country. Foreign investors are believed to be well established and they have credibility in domestic as well as global markets. However, sometimes foreign investors need local financial support to fund their local projects. In Nepal, there are some problems related to financing businesses in particular related to obtaining loans form commercial banks. Due to high interest rate, collateral issues and extensive and troublesome procedure make the investors reluctant to enter in the Nepali market. In this context Nepal is not considered a favorable destination for investment because of its small capital market.

CHAPTER VI

CONCLUSION

Foreign Direct Investment refers to any investment made by a party in one state into a company or organization in another country to develop long-term interest. For many nations around the world, foreign direct investment (FDI) is a significant source of external financing. Along with financial resources, FDI makes it possible to transfer managerial and organizational skills, technological know-how, and access to international markets, while also boosting the productive activities of the host economy (Nepal Rastra Bank, 2021). Least developed countries like Nepal need foreign capital and technology for rapid economic development.

Over the past few decades, the FDI outflow from developing economies has become a significant driver of economic globalization. The outward foreign direct investment (OFDI) from developing countries was first recognized in the late 60s when Emerging Multinational Enterprises (EMNEs) were investing in other developing economies. However, from about the early 1990s, the nature of the FDI trend in the developing nations considerably changed due to the changes in the dynamics of market forces and global acceptance of market-oriented economic policies (Athukorala, 2009). A wider sense of political and economic recognition of South-South cooperation among the southern or developing countries only emerged through the 1970s-80s. These developing countries wanted to reduce their extreme reliance on the northern countries or the developed countries through reciprocal sharing of the developing experiences, skills, and technology among the developing countries. The south-south cooperation turned out to be very instrumental for the developing countries' progress. The number of the EMNEs made their presence so strong and even expanded their presence beyond their traditional area to other developed economies. China and India are two major examples of developing countries that have made huge amounts of overseas investments and have garnered global attention.

Realizing the significance of FDI Nepal has been adopting liberal investment policies since the 1990s for economic progress. However, the overall image of FDI is underwhelming despite the government's open policy and alluring incentives. The immediate neighboring countries of Nepal, China and India are the highest contributors of FDI in Nepal. The above analysis of Indian and Chinese FDI in Nepal brings out that investing in Nepal has been one of the major instruments for India and China in meeting their strategic interest in Nepal. In the past India dominated the FDI in Nepal, however, in recent years China has been aggressively investing in Nepal. Before Nepal overthrew the monarchy in 2008, China engaged in silent diplomacy being heavily dependent on the monarchical ideology to pave the way for the country’s diplomatic interests. Nevertheless, after 2008, China actively engaged with political parties in Nepal thereby establishing a good rapport with them and looking to increase its influence in the country (Bhattarai, 2020). It was then China began increasing its investments gradually in Nepal across various sectors. The findings also suggest that there has been perpetual growth in Indian FDI over the years with no interruptions; however, India is far behind China. The study suggests that the total FDI made by China between 2008 to 2021 is Rs. 172.01 billion and India made a total of Rs 82.19 billion direct investment in Nepal in the same period.

Geopolitical factors alone are insufficient to draw in investment for any country. The country should have lucrative opportunities and favorable policies to complement those opportunities. Nepal has vast opportunities in terms of foreign investment. Market-based, policy-based, and sector-based opportunities make up the three categories of FDI potential in Nepal. With a population of more than 29 million, Nepal is a large market with easy access to more than 2.7 billion people to India and China. Moreover, Nepal is a member of various economic and trade related organizations like MIGA, SAFTA, and BIMSTEC and Nepal has signed BIPPA with six countries and DTAA with eleven countries. Policy wise Nepal has FITTA 2019 which governs the FDI in Nepal. There are several other policies like Intellectual Property Policy - 2017, Foreign Investment Policy -2015, Industrial Enterprises Act 2016, Labor Act 2017, and Company Act 2017, enacted to protect the rights of the investor. Sector-wise Nepal has vast potential in sectors like investment in energy, tourism, ICT, manufacturing, agriculture, health and education transport, mines and minerals.

In spite of having this kind of potential Nepal lags far behind compared to other South Asian as well as South East Asian countries. There are many obstacles that prevent FDI from entering Nepal. Attracting and sustaining investments in Nepal is difficult for a variety of reasons. Political, legal, institutional, policy, infrastructure, and resource issues are some of the primary problems. Political instability, overlapping and often incompatible laws and institutional frameworks, uneven priorities of various departments of government, huge gap between actual policies and their implementation lead to poor investment environment in Nepal. The FDI environment in Nepal is further hampered by other factors, such as a lack of critical infrastructure, including dry ports, SEZs, transportation, and resources like financial and skilled manpower.

It is found that Due to a lack of investment protection and promotion, Nepal has not even been able to fully realize its potential. Nepal should improve its institutional capabilities in order to promote and manage a foreign investment. Because complementary resources like capital, technology, and organizational skills are often rare in developing and least developed countries, existing resources like labor and natural resources stay underutilized. Therefore FDI can be a crucial channel for Nepal to obtain these complimentary resources from other nations especially its emerging neighbors India and China. The laws governing investment policies are often ambiguous accompanied by complicated processes for FDI registration and approval. The investment policies need to go through certain reforms. Nepal ought to be able to balance its foreign policy and take advantage of the strategic interests of its neighbors.

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