FOREIGN DIRECT INVESTMENT IN NEPAL: TRENDS, NEEDS AND PROSPECTS

A Thesis Submitted to

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LETTER OF RECOMMENDATION

This Thesis entitled "**Foreign Employment: Its Trend and Policy Analysis"** has been prepared by **Miss Muna Adhikari** under my guidance and Supervision. I here by recommend it for acceptance.

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APPROVAL LETTER

This thesis entitled "**Foreign Employment: Its Trend and Policy Analysis"** prepared by **Miss Muna Adhikari** in the partial fulfillment of the requirements for the Degree of Master of Arts in Economics has been accepted.

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LIST OF ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
APEC	Association of Petroleum Exporting Countries
ASEAN	Association for South East Asian Nations
BITS	Bilateral Investment Treaties
BOI	Board of Investment
CBS	Central Bureaus of statistics
CEDA	Centre for Economic Development and Administration
CEDECON	Central Department of Economics
DOI	Department of Industry
ESAP	Enhanced Structural Adjustment Program
FDI	Foreign Direct Investment
FI	Foreign Investment
FITTA	Foreign Investment and Technology Transfer Act
FNCCI	Federation of Nepalese Chamber of Commerce and Industry
FNM	First Ninth Month
FY	Fiscal Year
GATT	General Agreement on Tariff and Trade
GDP	Gross Domestic Product
GNI	Gross National Income
GNP	Gross National Product
HDI	Human Development Index
HDR	Human Development Report

IMF	International Monetary Fund
Ktm	Kathmandu
LDCs	Least Developed Countries
M.A.	Master of Arts
MDGs	Millennium Development Goals
MIGA	Multilateral Investment Guarantee Agency
MNCs	Multinational Companies
MOF	Ministry of Finance
MOI	Ministry of Industry
MW	Mega Watt
NEA	Nepal Electricity Authority
NIDC	Nepal Industrial Development Corporation
NPC	National Planning Commission
NRB	Nepal Rastra Bank
NRN	Non- resident Nepali
OECD	Organization of Economic Co-operation and Development
R&D	Research and Development
RNAC	Royal Nepal Airlines Corporation
Rs.	Rupees
SAARC	South Asian Association for Regional Co-operation
SAFTA	South Asian Free Trade Area
SAP	Structural Adjustment Program
T.U.	Tribhuvan University
TNC	Transnational Co-operations
TRIPS	Trade-Related intellectual property Rights
UK	United Kingdom
UN	United Nations

UNCED	United Nations Conference on Environment and Development
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
UNHDR	United Nations Human Development Report
UNO	United Nations Development Program
USA	United States of America
WTO	World Trade Organization
WB	World Bank

CHAPTER I

INTRODUCTION

1.2 Overview

Situated in the lap of Himalaya, Nepal is located between the latitude from 26°22'N to 30° 27' North and longitude from 80°4' E to 88° 12' east, and its elevation ranges from 90 to 8848 meters. The average length being 885km east to west and average breadth is about 193km. north to south. The country is bordering between the two most populous countries of the world, India on the east, west and south with an open border and China on the North. Nepal is a land-locked country and home place of natural beauty with traces of artifacts. Extraordinary diversities and similarities can be seen here. But economic growth of the country has not improved substantially over time to overtake population growth. As the current population growth is 2.25 % per annum, the gain achieved by development activities has been overshadowed by growing population. Nearly 31% of the population are still living below the poverty line in the abject condition. Economic situation is fragile and vulnerable engulfed by ongoing conflict and recession. Human development index (HDI) as of 2006, is 0.527, a little improvement over HDI 2005. Poverty gap was widening day by day.

Nepal still needs a big push for achievement of sustainable higher economic growth, macro economic stability and welfare to the poorest of the poor, when we observe back the weak performance of the planned development over 52 years and its huge resource expenses. This widening development demand and supply gap does not mean zero development. It means that we could not accomplish the desired level of development so the Nepal still remains in LDCs status.

Nepal is characterized by vicious circle of poverty. One of the major reasons of underdevelopment of this country is that Nepal lacks abundant capital to mobilize the existing resources of the country. The economic growth of any country depends upon the proper utilization of existing resources of that country and creation of new resources through improvement in technology and manpower. Hence, adequate capital is a must to pave the way for economic development of underdeveloped countries like Nepal. Therefore, foreign direct investment (FDI) is regarded as a tool, by which a country gets capital. FDI provides funds along with manpower, technology which encourages local enterprises to invest with foreign partner.

Actually, FDI occurs when an investor based in one country (the home country) acquires an asset in another country (the host country) with the intent to manage that asset (UNCTAD, 1999). In other words, it involves the acquisition of a business of other commercial assets in a country (the host country) by multinational enterprises, other foreign firms, or individual foreign residents with intent to manage the business or commercial assets in the host country. FDI is considered as a means of obtaining not only capital and technology but also scarce management and skill, and improved marketing 'know-how' and outlets for non-traditional exports of manufactures, processed commodities and traded services. FDI flows include equity investment by multinational enterprises, their reinvested earnings in foreign countries.

FDI is generally viewed as an engine for global development and the transfer of technology. This depends on access to new markets abroad, especially for manufactured goods; the new knowledge brought in; and the contribution to local technological capability building (Kumar, 2002). Multinational companies (MNCs) based on industrial countries are taken as the principal source of FDI. Some of the potential benefits of

FDI are enumerated as; (i) capital transfer, (ii) employment generation, (iii) transfer of technology skills and knowledge, (iv) enhancement of managerial capacity (v) access to world markets (vi) specialization of firms. At first glance foreign direct investment would seem to be uniquely beneficial for developing countries because it provides a vehicle for the transfer of scarce resources, and may provide both needed capital and foreign exchange. Furthermore, the effects of direct investment in the developing countries extend beyond the immediate transfer of resources. Foreign investment is an agent in the process of cultural borrowing that constitutes industrialization. It is a cross cultural change agent. Thus, foreign direct investment would seem to have the potential to contribute much needed resources to developing countries. Yet, it is by no means certain that the net results from a given investment will be positive. The situation is complex with foreign investment bringing simultaneous costs and benefits to host countries. It is obvious that foreign direct investment is viewed as less than universally beneficial (even in a net sense) by many in the developing countries.

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

Tourism is the biggest business in the world and there is hardly a country that does not seek either tourists or investment in tourism. Uniquely, Nepal offers some of the most spectacular tourist attractions in the world: 8 of the world's 10 highest mountain peaks, including the top of the world, mount Everest; an extraordinary range of climatic conditions ranging from the sub-arctic to the tropical and a corresponding range of flora and fauna, from the snow leopard to the rhino; a rich cultural heritage, from the birth place of the Buddha through medieval Hindu temples to nearly 60 spoken languages from several language families. Nepal also offers enormous potential for hydropower and a remarkable variety of agricultural products in the five climatic zones packed into a north- south breadth of 150-250 kilometers.

In 1990, multi- party democracy was restored after a hiatus of nearly 30 years. It was a peaceful revolution. In 1992, the Government introduced a new policy on foreign direct investment (FDI) and instituted a "one- window" system to facilitate and encourage it. Although, as it perhaps to be expected investors are not wholly satisfied with the FDI regime and express reservations about whether the one-window system is actually living up to its name, there is also a consensus that the country welcomes investors and that its regime is liberal by South Asian standards. The Department of industries, the government organ responsible for matters dealing with foreign investment, is widely seen as being helpful to investors. FDI currently in the country represents a wide range of companies and countries in a larger number of areas from- agriculture, through banking, hydropower and manufacturing, to tourism.

Nepal is located between two of the world's largest markets; China on the north and India on the east, west and south. With India in particular, Nepal shares much of its cultural heritage and what is in effect an open boarder. A trade treaty signed in 1991, and renewed in 2002, guarantees Nepali manufactures duty-free access to the Indian market, subject to certain qualifications. While India too is a poor country, it has a fairly sizeable middle class with a some purchasing power. Another advantaged in this context is offered by Nepal's significantly lower tariffs on imports, as compared to India's which can make Nepal, an attractive location even to Indian investors whose products require third-country inputs. It should be noted that, despite Nepal's proximity to china and India, these are not the only markets for Nepali exports. As a least developed country, Nepal is also entitled to preferential treatment in a number of developed country markets.

The natural as well as cultural assets of Nepal offer very substantial opportunities to investors. The country has a range of climatic conditions. From tropical to sub- arctic within a relatively narrow band which is no more than 250 kilometers at its widest, north- south. The terrain is generally mountainous in the north, hilly in the middle and near sea level in the south. Many niche agricultural products can be grown in Nepal, medicinal herbs and high- quality tea being but two examples. There is also huge potential for hydropower. About 44,000MW is thought to be economically feasible which may be contrasted with the 556MW currently being generated an India –Nepal agreement on power trade is in place and the Indian states along the Nepali border, perpetually short of power, offer an obvious market. In addition to the development of electricity for export, the hydropower resources offer the prospect of developing energy- intensive manufacturing activities.

FDI can be attracted through appropriate incentives. This would require substantial economic policy changes since foreign capital will only flow where the favourable treatment for foreign investors is assured. The internal policy measures as well as the trend of macroeconomic indicators play a vital role in attracting foreign investors. The sluggish GDP growth, high inflation rate, excessive population growth, high degree of saving- investment gap, unbridled corruption, non- committed government policies and on the whole, lack of people based political commitment discouraged the flow of FDI in the past. It is hoped that those countries which participated in the past regime will feel the newly set-up foreign investment climate more congenial in the years to come. Government of Nepal encourages foreign investment in medium and large industries in various sectors of economic activity giving monopoly opportunity to Nepalese citizens only in the case of small and cottage industry. The only exception made is the defense industry. Potential investors could propose projects outside the list of projects suitable for foreign investment identified by government of Nepal. Such proposal should be in line with the national priority of Nepal either as import-substitution industries, export- oriented industries or assembling industries. Besides a policy level reform with the international environment, the Government should try to campaign and convince foreign investors so that the possible constraints of the future could be minimized.

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

1.2 Statement of the Problem

As political stability and peace are the sine quonon for attracting greater volume of FDI in Nepal, Nepalese economy has suffered from serious structural constraints accompanied by unprecedented political turmoil since many years. Economy is characterized by landlocked position, rugged topography with limited cropland, poor resource base, a high extent of poverty and rampant corruption. Similarly, Nepalese economy has suffered from limited resource endowment, underdeveloped infrastructure, technical know how, unskilled manpower, improper planning, ineffective implementation of policies etc.

Nepalese economy is passing through the critical phase of low level equilibrium trap circumscribed by poverty and stagnation (Dahal et al. 2000). Macroeconomic indicators exhibit that Nepal's economic status is vulnerable in terms of GNI per capita, commercial viability of natural resources, the extent of poverty and human development prospects. Nepal is bound with traditional society where people almost depend upon the old primary and traditional industries having inadequate modernized tools and technology.

Foreign investors have vented dissatisfaction with the frequent changes of the officials of the concerned offices. Government has not been able to create favorable market access to neighboring countries for the products of foreign investment projects through trade agreements. Private sector has no confidence with the government and has low expectations regarding the value of promised incentives embodied in the policies. This sector has also reservation about government control. Because of the lengthy approval process and incentive system, Nepal has been regarded to the country with the poorest level of investment climate.

An assessment of policies that addresses foreign investment prospects on the basis of existing investment climate in Nepal is thus considered as the focus of the present study.

With the liberalization and privatization policies undertaken in the 1990s, Nepal should have been able to attract more FDI and private capital Flows. But present scenario reveals that the ability of Nepal to attract private capital and FDI has been less than anticipated. Despite the ample facilities and liberal legal provisions, the disappointing flow of FDI to Nepal has emerged as a problem. So, it is desirable to study;

- why foreign direct investment inflow to Nepal is less than anticipation?
- what are its nature and extent?
- what are the policies adopted and incentives given?
- what type of contribution does FDI afford to Nepal ?
- what are the prospects of FDI in Nepal?
- how foreign direct investment is important for the overall development of the country?

1.3 Objectives of the Study

The major objectives of this study are as follows:

- To analyze the past trend of FDI in Nepal.
- To examine existing policies and incentives relating to foreign investment in Nepal.
- To examine the prospects of FDI in Nepal.
- To examine the needs of FDI in Nepal.
- To suggest recommendations.

1.4 Significance of the Study

FDI has been an important avenue of private external finance for developing countries like Nepal. If differs from other types of external private capital flows in that it is motivated to a large extent by the investors' long-term goal of profit making in production activities that they directly control. FDI adds to investible resources and capital formation; and it is also a mechanism of transferring production technology, skills, innovative capacity, and organizational and managerial practices between locations, as well as of accessing international marketing networks.

As Nepal is wedged between two economically powerful nations China and India, there is high possibility of attracting FDI towards this country. For this, peace, political stability, good governance and proper policies towards FDI are crucial to attract the greater volume of FDI into this country. So the inflow of foreign capital and skill through the foreign private investment is necessary, if Nepal's effort towards economic growth and development is to be made easier and faster. The inflow of foreign investment in Nepal is less than impressive. Further, the study on the prospects, trends and contribution of FDI in Nepal is crucial.

1.5 Limitations of the Study

The study has been mainly based on the secondary data for a period of 18 years from FY 1989/90 to FY 2006/07. No test has been done for the check of reliability of those data. This study aims to analyze the trends of FDI inflow into Nepal up to FY 2006/07, prospects of FDI in Nepal and needs of FDI for the economic development of Nepal. The study is subject to general limitation of thesis work for the partial fulfillment of the requirements for the master's degree (M.A) in economics. Due to the time and resource constraint, primary data has not been collected.

1.6 Organization of the Study

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

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

Chapter three is concerned to the research methodology used in this study. This chapter comprises of research design, nature and sources of data method of analysis and definitions of key terms. Chapter four is related to laws and policies relating to foreign direct investment.

Chapter five is related to trends and performance of FDI in Nepal. Chapter six is related to prospects and needs of FDI in Nepal. Lastly, chapter seven includes summary and conclusions of the study and the recommendations that may be helpful in formulating policies. This chapter is followed by appendices and references.

CHAPTER TWO

REVIEW OF LITERATURE

2.1 Theoretical Framework

2.1.1 Conceptual Considerations

Foreign Direct Investment (FDI) occurs when an investor based in one country (the home country) acquires an asset in another country (the host country) with the intent to manage that asset (UNCTAD, 1999). FDI is considered as a means of obtaining not only capital and technology but also scarce management and skill, and improved marketing know-how and outlets for non- traditional exports of manufactures, processed commodities and traded services (Chitrakar, 1994).

In neoclassical economic theory, FDI primarily implies the movement of productive capital from one country to another. When productive capital goes from capital-abundant countries to capital scarce countries, it promotes greater world production and economic welfare in the same way as expansion of international trade in goods under trade liberalization, and accordingly. FDI is considered to be a substitute for international trade in goods. In this respect, high tariffs and other barriers to trade can induce FDI, but with little beneficial effect on domestic resource allocation and economic welfare in highly distorted host countries, FDI is focused on servicing only small ‘inward- looking’ markets.

Kindleberger defines foreign investment as "Balance of payments accountants defined as direct foreign investment as any flow of lending to, or purchase of ownership in a foreign enterprise that is largely owned by residents of the investing country" (Kindelberger, 1965).

FDI is considered less prone to crisis because direct investors, typically, have a longer-term perspective when engaging in a host country. In addition to the risk- sharing properties of FDI, it is widely believed that FDI provides a stronger stimulus to economic growth in host countries than other types of capital inflows. The underlying argument is that FDI is more than just capital, as it offers access to internationally available technologies and management know-how (The Economist 2001).

> According to UN (2002a:5), "Private international capital flows particularly foreign direct investment . . . are vital complements to national and international development efforts. Foreign direct investment contributes toward financing sustained economic growth over the long term. It is especially important for its potential to transfer knowledge and technology, create jobs, boost overall productivity, enhance competitiveness and entrepreneurship and ultimately eradicate poverty through economic growth and development". In a similar vein, the OECD (2002a:11) reckons that " Increasingly, FDI has been recognized as a powerful engine and a major catalyst for achieving development, poverty- reducing growth and global integration process".

The favorable perception of FDI contrasts remarkably with the formerly skeptical, if not hostile attitude, which prevailed also in UN organizations towards the activities of multinational corporations in developing countries. However, it would not be for the first time if a backlash occurred and multinational corporations were again, as in the

1970s "denounced as big, irresponsible, monopolistic monsters". (The economist, 2000)

According to the Balance of payment manuals (IMF, 1977) "Foreign investment refers to investment made to acquire lasting interest in enterprises. Further, in case of FDI, the investors' purpose is to gain as effective voice in the management of the enterprise". The benchmark definition of the organization for Economic Co-operation and Development (Paris 1983:85) is that , "a direct investment enterprise as an incorporated or unincorporated enterprise in which a single foreign investor either owns 10 % or more of the ordinary shares or voting power of an enterprise (unless it can be proved that 10 % ownership does not allow the investor an effective voice in the management) or owns less than 10 % of the ordinary shares or voting power of an enterprises, yet still maintains an effective voice in management". An effective voice in management only implies that direct investors are able to influence the management of enterprises and does not imply that they have absolute control. The most important characteristics of FDI which distinguishes it from portfolio investment, is that it is undertaken with the intention of exercising control over the enterprises.

The Earth Summit, United Nations Conference on Environment and Development (UNCED) held in Rio de Janerio in 1992 discussed chapter 33 of Agenda 21 and then recommended about FDI (www.undp.org) as follows.

- FDI should account for a larger share of poverty alleviation and sustainable development financing,
- Need to link to local enterprise development, and

- Promotion of incentives for environmentally and socially responsible investments, particularly in the least developed countries.

According to Kobrin, "Foreign investment is an agent in the process of cultural borrowing that constitutes industrialization. The aspect of culture transfer trends to be diffused throughout the host society by the reemployment of trained personnel, backward and forward linkages and competitive emulation" (Kobrin, 1977:321). In the opinion of Prof. Nurkse, "The use of foreign resources is one way of breaking the vicious circle of poverty and low capital formation. The flow of foreign capital and other resources will provide an increase in productivity fast enough to out running population growth and thus launch a process of cumulative expansion, and will acquire sufficient portion of this capital in foreign exchange to permit importation of raw materials and equipment needed for development in addition to essential food stuffs" (Nurkse, 1972: 57).

At the turn of present century, private foreign capital mostly flowed in the form of indirect investment from Europe to the underdeveloped countries. Such capital as flowed to low income countries in the 1920s in the form of direct investments went into production for export, very little of it went to manufacturing for the home market (Nurkse, Op. Cit., P. 83).

Until the 1980s, most developing countries viewed it with great wariness. The presence of multidimensional corporations (MNCs) was perceived to impinge on national sovereignty and security. The foreign based center of decision making and international mobility raised suspicious about MNC commitments to the host economy. The sheer size and magnitude of FDI by MNC was viewed as a threat to host countries, raising concerns about MNC’s capacity to influence economic and political affairs.

In recent years, FDI restrictions have been dramatically reduced as a result of host factors-accelerating technological change, emergence of globally integrated production and marketing networks, existence of bilateral investment treaties, prescriptions form multilateral development banks and positive evidence form developing countries that have opened their doors to FDI. Relative to world output, total trade and FDI inflows have raised tremendously since the early 1990’s (ADB, 2003).

In the book, the Japanese Economy: Trade Industry and Government, Ryutoro Komiya had examined the relationship between trade, industry and government in the Japanese Economy in 1990s. He found two forms of FDI -securities and portfolio long-term capital. He primarily observed FDI as a form of long-term international capital movement, made for the purpose of productive activities and accompanied by the intention of managerial control or participation in a foreign firm. It is distinguished from indirect (Portfolio or securities) long-term investments where the investor is concerned only with the yields on securities or other claims acquired.

Examining the impact of FDI, the earliest empirical study, the International Cooperation of National Firms: A study of Direct Foreign Investment, Hymer broadly describes FDI as not simply a transfer of capital but the transfer of a package of capital, management and new technology. Thus, the host countries can benefits from the inflow of FDI into capital, management and new technology. Therefore, FDI should be understood in the form of transfer of capital, management and new technology from MNC.

Describing its relationship between parent company and host country's enterprises, UNCTAD defines FDI as an investment involving a long term relationship and demonstrating a lasting interest and control it by a resident entity in one country (parent enterprise) in an enterprise resident in a country other than of that Foreign Direct Investor (Cited Sigdel; 2005). Basically, the parent company controls and operates host country's company towards its interest through FDI. Thus, we can understand FDI as capital investment of parent company in the form of securities or portfolio investment in the host country's company with its own goal and control for long period. It may have transfer possibility of management and technology from the parent company to the host country's company. Thus, it can be called as an indicator and measure of the globalization.

The growth of private foreign direct investment (FDI) in the developing world was extremely rapid during the post decades. It rose from an annual rate of $2.4 billon in 1962 to $11 billion in 1980 and 35 billion in 1990 before surging to over and 185 billion in 1999. Almost 60% of this total goes to Asia (Tadaro and Smith, 2003, 635).

2.1.2 Benefits of FDI

FDI may have wider and technological benefits through its spill-over effects, it could also discourage the development of technological know-how by and in local firm and institutions, to the detriment of the growth of domestic producers and the national economy (South Centre 1997: 37).

The possible benefits of FDI include the transfer of technology to individual firms and technological spill-over to the wider economy; increased productive efficiency due to competition form multinational subsidiaries; improvement in the quality of the factors of production including management in other firms and not just the host firm; benefits to the balance of payments thought the inflow of investment funds; increase in exports; increase in savings and investment, and hence faster growth of output and employment, consumers may benefit both form lower prices of goods and the introduction of new or better quality goods (South Center 1997; 36-37).

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

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

"Foreign direct investment (FDI) can play a key role in the economic growth and development process. The importance of FDI for development has dramatically increased in recent years. FDI is now considered to be an instrument through which economies are being integrated at the level of production into the world of globalization by bringing a package of assets, including, capital, technology, managerial capacities and skills, and access to foreign markets. It also stimulates technological capacity-building for production, innovation and entrepreneurship within the larger domestic economy through catalyzing backward and forward linkages" (UNCTAD, 1996a).

FDI is perceived superior to other types of capital inflows for several reasons:

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

2.2 Foreign Direct Investment in Nepal

Brief History

In the context of Nepal, history of foreign direct investment is very short as compared to that of USA, UK, France etc. FDI in Nepal can be observed from four groups of political economic history of modern Nepal. They are (a) Earlier period (1760 – 1840) (b) Rana Regime (1840 -1950) (c) Panchayat regime (1960 – 1990) and (d) Restoration of democracy 1990 onwards).

a) Earlier period (1760s – 1840s)

In earlier period of political economy history of modern Nepal, Late Great King Prithivi Narayan Shah developed and adopted the nationalist policy prohibiting foreigners in Nepal for any purpose for preserving “nationalism, independence and sovereignty” between two giants – India and China.

b) Rana Regime (1840 – 1950)

After the rise of Rana Regime in Nepal, Late Shree Teen Prime Minister Jung Bahadur Rana followed the traditional nationalist policy in his earlier rule. He made it liberal balancing and making cheering particularly to British Empire for preserving nationalism, independence and sovereignty" of Nepal. The formation of Udyog Parisad in 1935 was the initial spurt towards industrialization in Nepal, this was followed by Nepal Company Act 1936. the act made provision for the incorporation at industrial enterprises or joint-stock principles. Biratnagar Jute Mill, the first joint – stock public company was established n 1936 in collaboration with Indian enterprises and local counter part with a paid up capital of Rs. 800,000.

The great World War II pushed up demand of jute products encouraging foreign investment in Nepal particularly in jute production. Then FDI inflow increased in the production of handmade papers, soap, ceramic, furniture, mats, textile and cigarettes. But most of these joint ventures closed after the end of the Great World War II.

c) Panchyat Regime (1960s'-1990s')

In 1960s', political system having a clear vision and mission of the King Mahendra Bir Bikram Shah was shaped into Panchayat regime. However, the political transition of 1960s' could not favor to FI, till 1980s. In the subsequent years of 1980s', Nepalese economy was suffering from macroeconomic crisis. In such situation, Nepal had not alternative except to implement structural adjustment program (SAP) introduced and developed by World Bank and IMF. In the SAP, Nepal could get financial assistance from the WB and IMF. Nepal began structural reforms by devaluating Nepalese currency with dollar by 14.7 %. Nepal liberalized the role of private sector and FDI. In 1980s' the government of Nepal had reviewed commercial Act-1984 and then liberalized the financial sector for Joint Venture Investment in Commercial Bank. Consequently, Nepal Arab Bank Limited was established. The SAP was continued till 1989. During the period, the flow of FDI began to come in Nepal in financial and service sector.

d) Restoration of Democracy (1990s'-the Present):

The wave of globalization in the world and the restoration of democracy in 1990 have made liberal political economy as a foundation of market economy. Accordingly, SAP was recharged into Enhanced Structural Adjustment Program (ESAP) under which Nepal followed liberal policy reforms in all sectors (taxation system, industry, trade, investment, service sector, and water resources) to ensure people's higher aspiration and as a preparatory requisite to enter WTO. Thus all economic sectors except security, media, micro enterprises, traditional agro-enterprises and few sub-sectors related tourism, have been made liberal for FDI and private sector. It has made optimistic about the inflow of FDI, although the policy failed to attract the expected FDI in the expected areas of the plan.

2.3 Recent trend of FDI in Nepal

After the restoration of multi-party democracy, there are high hopes for a competitive and profitable economic system in Nepal. As such, the priority is for privatization which calls for a better reformation in overall policy matters. They include the proposed industrial policy, foreign exchange liberalization, follow up and supervision of the existing big projects, and monitoring of the development projects on a regular basis. Such positive factors help enhancing the overall climate for foreign investment.

Nepal is still in the early stage of industrial development which accounts for about 10 % of the GDP. Modern industrial development has started only recently and therefore, opportunities for profitable investment are very promising. With the initiation of the structural adjustment program, the new strategy for trend and industry is being set in motion. In this situation, investors are assured of a trade and industry regime which will eliminate excessive regulatory controls provided simplified and responsive administrative arrangements and improved access to the necessary factors of production and input.

FDI trend may be positive or negative in general, however, the case of Nepal is declining during the last couple of years through it registered a steady growth during the initial years of liberalization. The most influential factors are the policy and political environment for the growth of FDI for a particular nation. These are the necessary conditions to attract the inflow of the FDI within country. The otherwise cases seem to be ineffective for the fact that incentives and innovations are the prerequisite for the investors to invest. Nonetheless, the international and regional variables play role in determining the flow of FDI. In general, FDI pundits advocate the trend of FDI should be increasing to achieve the sustainable economic growth.

Statistics reveal that FDI in Nepal is relatively on small proportion that compared to other south Asian Countries. The overall trends show the fluctuating nature of FDI at different time segment. Dividing the period from 1980s' to 1990s' into two distinct periods, the trend can be analyzed. First covers the period of SAP implementation during 1980S' and second analyzes the ESAP implementation period after the restoration of democracy in the country in early 1990s'. In 1980s', the SAP opened up the entry of FDI in certain areas. That partial liberalization attracted FI in financial and service sectors that were very important to FDI inflow in Nepal. The initial years were followed by the increasing FDI though not at satisfactory level.

In the post democratic years, the trend line has been in fluctuation with higher rate in the country that has negatively affected to macroeconomic stability and economic growth in the economy. The trend line from 1990 to 1994 was positively increasing with higher rate. For the initial year from 1995 to 1996 the decline can be attributed to the effects of the beginning of Maoist's peoples' war. During subsequent period from 1996 to 1998, the trend of FDI followed the path of steady increase. In 1999, it slipped down because of deteriorating political and economic environment. During three successive years FDI continued to decline as result of Maoist insurgency, political movement and other disturbances. In 2003, the trend of FDI again started to follow the increasing path.

2.4 Policy Environment

Policy environment covers the review on existing policy related to FDI that includes industrial policy – 1992, Foreign Investment and Technology Transfer Act – 1992, and Tenth Five Year Plan (2002-2007). It describes policy environment for FDI attraction, utilization and management in Nepal as compared with South Asian countries i.e. India, Sri Lanka, Pakistan, Bangladesh, etc. and China.

Liberalism in 1990's came into the political economy in Nepal, when the popular people's movement restored liberal political system called democracy. Its reflection can be found in policy reforms in the context of the process of globalization, existence of resource gap and higher expectation of the people. Investment environment that is required to ensure the investor for their investor security can be made through the policy reform. The policy environment is comprised of three major polices. They are:

a) Foreign Investment and Technology Transfer Act – 1992.
b) One Window Policy 1992.

c) Industrial Policy 1992.
d) Tenth Five Year Plan (2002-2007)

2.4.1 Foreign Investment and Technology Transfer Act-1992

In 1992, the government revised to the existing Foreign Investment and Technology Transfer Act. The policy is considered as a milestone in liberal and competitive national policy in the south Asian context. Its policy goal are to encourage the private participation, improving industrial production and productivity through the utilization of foreign investment, advance technology and domestic resources and promoting competitive power of industrial products accessing international market.

The act clearly accepts FDI form (Share and reinvestment, loan) and also adopted technology (rights, formula process, specialization, patents, trademark, goodwill, technical service and consultant) in the middle and large scale industries except in the negative listed industries (defense, cigarettes, bidis and alcohol) and cottage and small industries. However, the act allows technology transfer also in cottage and small-scale industries for increasing production and productivity.

The act ensures the investors about security of investment through provisions of no nationalization and international standard dispute settlements. Besides it, the government has provided fiscal incentives particularly on income tax and drawback facilities of sale tax, excise tax and import duty on raw materials, along with repatriation and expatriation facility in foreign exchange. To encourage the investors, the government has simplified visa procedure and provision particularly to the foreign investors and infrastructure facility required to the FDI industries.

2.4.2 One Window Policy 1992

Service delivery system is a key determinant of FDI. Generally, it should be effective to maintain the investment climate. However, long, confused, discouraging, harassment and corrupt administration of the government in service delivery system in Nepal was barrier in the path of industrialization process before Foreign Investment and Technology Transfer Act and One Window Policy 1992. In order to improve efficiency and productivity of administration for attracting FDI, the government has systematized all service delivery system into one channel to deliver service required to the investor under one roof through one window policy.

The policy that is a part of investment environment for FDI attraction has formed One Window Committee for administrating the related services and delivering them to the investors. The policy delivers the following services.

- Facilitating services of registration, land, electricity, water etc and other infrastructure facility and fiscal incentives through one window Committee for One Window Service Delivery System.
- Decision relating to permission taken by the board within 30 days.
- Describing all facilities and concessions to the industries in the letter of permission.
- Granting permission within 21 days after the submission of application in Department of Industry.

2.4.3 Industrial Policy 1992

Focusing industrial development led economic growth and economic development as required in the plan development Nepal has given significant attention on development of favorable policy environment for accelerating industrialization process within short history of industrial development. For the fist time, Nepal formulated industrial policy in 1962 and revised it in 1965. Later, Nepal introduced three industrial policies between 1974 and 1987. They carried discrimination and distortion experience in structure, quantitative restriction, licensing, regulatory in their implementation. So, industrial sector suffered from substantial distortion and inefficiency in recourse allocation.

In 1992, Nepal formulated new industrial policy to depart from the past policy distortion, discrimination and inefficient resource allocation with the philosophy of liberalization and privatization. The policy opens the private sector in production, investment and distribution for the development of free and fair competitive environment so as to increase industrial production and productivity for increasing industrial contribution to the economy. The policy emphasizes the development of large and middle scale industries. Besides it, the policy encourages labour intensive, export intensive and local resource based industries.

The policy is of dualistic nature. On the one hand, it focuses on free and fair competition for comparative advantage of the country. On the other hand, it emphasizes on the protection of domestic industries. Besides it, the policy gives special attention on export intensive and import substitution large and middle scale industries and also small, cottage and agro-based industries. Apart form it, the policy gives priority to the development of FDI attracting environment along with transfer of advance technology and management.

The policy aims at increasing the contribution of industrial sector in national economy by increasing industrial production and productivity; put emphasis on the development of industries using local materials and export-oriented industries; reduce pressure of unemployment and under-employment on agriculture by developing employment – oriented industries; adopt appropriate policy of industrialization for balanced development of all sectors.

The policy, to accelerate industrial development and growth and to achieve above objectives has set up the institutional mechanism for efficient, fast, transparent, reliable and simple service delivery system. They are:

- Industrial Promotion Board.
- Institutional Development for Cottage and Small Scale Industries
- Industrial Estate Management Ltd.
- Fiscal Management for Cottage and Small Scale Industries.
- Export Promotion Zone.
- Council for Industrial Human Resource and Productivity.
- Special Management for Environment and Industrial Pollution.
- Monitoring Cell.
- Establishment of Company Register's Office.
- One Window System.

Industrial policy has been just revised but is not updated in the post era of Nepal's WTO membership. The policy reforms, however, failed to accelerate the industrialization process as targeted in the past national plans.

2.4.4 Tenth Five-Year Plan (2002-2007):

The sole objective of the Tenth Five Year Plan is to reduce the poverty from 38 % at the beginning of tenth plan to 30 % by the end of tenth plan. To achieve the objective, the plan has adopted the strategy of high and broad-based economic growth through industrial development investment promotion.

2.4.4.1 Foreign Investment

The Plan carrying sentiments of foreign investment policy 1992 and industrial policy 1992 incorporates reality of need and importance of FDI for addressing the resource constraint for industrial development, international market access and acceleration of GDP growth. It seems to be committed to promote foreign investment for foreign capital, advance and modern technology and managerial skill for international market access. So the plan is to develop, secured and reliable destination of foreign investment to Nepal at the international level.

The mid term evaluation of Ninth Five years plan has identified problems related to foreign investment that comprises relatively small domestic market, limited capital resources and infrastructure, administrative hurdle and harassment, show administrative decision making, lack of skilled man power, lack of security and promotional program. The tenth plan sets strategies and policies particularly addressing this problem. The plan adopts three policy measures, which includes administrative reform legal reform and foreign investment promotional program.

- Administrative Reform: Accepting reality of ineffective state functioning and hurdles on one window committee as found in the observation and the discussion with industrialist Journalism, economist, business people etc. the plan gives top priority on the implementation side of One Widow Committee. So, the plan has followed administrative and legal reform to make the procedure of foreign investment into simple, transparent, easier and to regulate monitoring system to address problem of foreign investment based industries.

- Legal Reform: The plan is under the pressure of competition with India, Bangladesh, Sri Lanka and Pakistan related to foreign investment that focuses on improving competitiveness of Nepal to compete with south Asian Countries for attracting more foreign investment in the county. For this purpose, the plan has the following strategies and policies preparation of comprehensive and depth research related to foreign investment for improving competitiveness, reviewing Foreign Investment and Technology Transfer Act 1992, Industrial Entrepreneur Act 1992, Labor Act for making foreign investment friendly and exploring solution of labour problem in exportable industries.
- Foreign Investment Promotion: The plan emphasizes the proper implementation of the existing government mechanism and agencies with realization that the Board of Investment and Nepalese Embassies are not operated effectively for foreign investment promotion.

2.5 FDI under the Three Year Interim Plan

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

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

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

2.6 Review of Nepalese Studies

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

- Most investments in Nepal are small and most investors are individual than companies as such. Most of those consulted by UNCTAD were however corporate investors.
- Some 40% of the FDI in Nepal are Indian. This is of course, to be expected, given the open border between India and Nepal and the historic links between the two countries.

- That the insecurity created by the Maoist insurgency is not a greater concern to the private sector than it appears, is a further fact worth noting. The past trends show that the larger volume of FDI has been concentrated to Kathmandu valley which has been relatively unaffected by the insurgency.

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

. Dangal (2002) in his M.A. dissertation entitled as The Problems and Prospect of Foreign Investment in Nepal submitted at the CEDECON studied the need, nature and extent of FDI in Nepal, observed the laws and policies and other general determinants of FDI including motivating factors affecting decision to invest in Nepal, problems and prospects of FDI in Nepal. His study supported by both primary and secondary sources revealed foreign investment scenario in Nepal has been dismal. Despite it's free market reforms and incentives, Nepal has attracted only a small portion of FDI flowing to South Asia. The analysis of flow of FDI in the country reveals that it commenced to flow remarkably into Nepal from the time when democratically elected first government of Nepali Congress adopted liberal policies in the matter of getting private domestic or foreign investors involved into the economic activities of a country.

Sharma (2003) carried out a dissertation submitted to the CEDECON on the Foreign Investment in Nepal and Its Impacts on the National Economy with the following objectives.

- To find out the situation and trend of foreign investment in Nepal.

- To understand the problem of foreign investment Titration in Nepal and the policy improvement made by the government overtime to attract foreign investment.
- To understand the impact of foreign investment of Nepalese economy.

She has adopted data collection procedure, available data on the subject have been interpreted in terms of year- wise trend, sector-wise trend, category- wise trend, plan-wise trend, country wise trend status-wise trend and the trend with reference to the scale of investment.

Her Conclusion was;

- The inflow of foreign capital in the form of foreign investment shows an improvement in the period after B.S. 2046 compared to the period before that,
- Government has made some essential provisions that are considered essential by the international community e.g. Nepal secured the membership of MIGA for ensuring guarantee of investment and repatriation of all investment and earnings. The government also signed an agreement of avoidance of double taxation and the protection of fiscal evasive with respect to taxes in income.
- The changes in the trade sector performance after the inflow of foreign investment reflects adequate indication for optimism as well as pessimism. Drastic shift in the concentration of trade from India to other countries, growing export rates, decreasing share of primary and capital goods accompanied by increasing share of manufactured goods in exports, are the reasons for optimism.

An initial study has been taken by Chitrakar (1986) under the supervision of CEDA on Foreign investment. His topic was Foreign Investment in Nepal published in given date. It was the first findings concerning with foreign investment. His research objectives were the

- Extent of foreign investment on Nepal.
- Policies and incentives introduced to foreign investment in Nepal.
- Investment strategies of multinational meeting held in 1982.

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

The research found that national attention and attempt to the policy reforms to attract FDI is not sufficient to increase the inflow of FDI in the country like. The collective efforts at the regional and international level are required for the growth of FDI inflow.

He has also mentioned some problems in attracting FDI like lack of predictable and transparent policy, absence of monitoring mechanism to accurately monitor the flow of FDI, political instability, and so on.

Basnet (2003) Carried out a dissertation submitted to the CEDECON entitled Foreign Direct Investment in Nepal The major objectives of his study are:

- To examine the overall structure of FDI in Nepal.
- To analyze foreign financial collaboration in Nepalese Industries.

- To find out the problems and constraints of FDI in Nepal.
- To suggest recommendation.

The researcher found that, in Nepalese economy FDI has played very crucial role, approximately 14% of the total budget of 96.1 billion was contributed in the given FY 2059/60. He used both primary and secondary data in order to fulfill the above objectives. He ahs used primary data for finding out the third objective.

Gnawali (1994) has mentioned the future constraints of FDI flows into Nepal as follows.

> *HMG/N encourages foreign investment in medium and large industries in various sectors of economic activity giving monopoly opportunity to Nepalese citizens only in the case of small and cottage industry. The only exception made is the defense industry. Potential investors could propose projects outside the list of projects suitable for foreign investment identified by HMG/N. Such proposals should be in line with the national priority of Nepal either as import-substitution industries, export-oriented industries or assembling industries. Besides a policy level reform with the international environment, the government should try to campaign and convince foreign investors so that the possible constraints of the future could be minimized.*

In this article, he has also mentioned the some factors which are responsible for poor performance of attracting the FDI into Nepal.

> *Lack of political commitment on the one hand, and structural deficiency including corruption, red-tape, unnecessary licensing procedures, multi-widows process etc. were responsible factors for the poor performance.*

Similarly, the restrictive national priority contributed to the lack of foreign investment.

Timilsina and Mahato (1998) in their book Economic Development and Foreign Investment in Nepal: Issues and Perspectives published by Nepal society for applied economics explain that the foreign direct investment is a means of industrialization which would lead to diversify the economy for a durable, social, psychological and institutional framework. To quote them, “foreign investment is considered important for the industrialization of Nepal. Some basic features associated with the direct foreign investment are that it will attract capital, technology, and expertise furthermore it will help to share risks, exploit resources presently and provide access to export market, all these factors are either in short supply or absent in Nepal”.

They take industrialization as a means of breaking the vicious circle of poverty thereby raising the formation and accumulation of capital in capital scare countries like Nepal where industrial development is considered necessary for the purpose of achieving various economic goals like higher rate of growth, fulfillment of the basic needs, creation of more employment opportunities etc. They mean “Industrialization is to break vicious circle of poverty and create prosperity through the process.” Further they opine that industrialization is to overcome the limited “carrying capacity” of agricultural sector in terms of employment, poverty alleviation and overall economic development. For this, some basic requirements are capital, appropriate technology, skilled human resources, market, infrastructure and favourable administrative and legal environment that could be fulfilled through the inflow of foreign investment.

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

Dahal and Aryal (2002) in the book entitled Nepalese Economy: Towards Building a Strong Economic Nation State under the topic Foreign Direct Investment in Nepal with special references to Indian joint ventures write:

> *In a poverty-stricken economy like Nepal where internal resources are extremely limited, not enough to supplement current expenditures, and dependence of foreign aid (grants and loans) is increasing with poor performance shown by economic growth rate; and where political conflict is getting momentum, the role of FDI is crucial not only to sustain development activities but also for poverty alleviation.*

The data for FDI reflects that investment form India is prominent, attributing to both economic and social proximity between Nepal and India. A pragmatic strategy for development based on two pillars would help achieve the target of attaining a high level of growth and poverty alleviation. These are (a) improving the investment climate though strengthening macroeconomic stability, trade openness and competitive markets, improving governance and institutions and infrastructure and (b) through social inclusion, good governance and poverty reduction (Stern, 2002).

CHAPTER III
METHODOLOGY OF THE STUDY

3.1 Source of Data

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

3.2 Collection of the Secondary Data

The secondary data have been collected from many sources such as Department of Industry, Foreign Investment Promotion Section of Ministry of Industry, Central Library of T.U., NIDC, CBS, CEDA Library, NRB, DOI, MOF, FDI Dept, NPC etc. Secondary data thus collected from different offices and departments have been further processed and analysed to find out the past trend and structure of FDI in Nepal, future constraints of FDI flows into Nepal and prospects of FDI in Nepal.

3.3 Data Analysis

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

3.4 Time Period of the Study

This study has been mainly based on secondary data for a period of 18 years from FY 1989/90 to FY 2006/07.

3.5 Definition of Key Terms

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

CHAPTER IV

LAWS AND POLICIES RELATING TO FOREIGN DIRECT INVESTMENT IN NEPAL

4.1 Foreign Direct Investment in Nepal

The history of foreign investment goes back to 1951-52 A.D when Nepal Commercial Corporation was set up as a joint venture with 67 % equity of Indian investors. The registration process was slow with slightly more than 10 units being registered during the 1960s. In 1961, there was a provision of foreign investment in medium scale industries with the investment of Rs. 50,000 to Rs. 500,000 and large-scale industries with the investment of more than Rs. 500,000.

4.1.1 Foreign Investment and Technology Act, 1981

The first official acknowledgement of the importance of foreign investment was recognized in Sixth Five Year Plan (1980/81- 1984-85), where it was delineated that foreign investment and technology was required primarily in large scale industries and mineral-based industries. As a result, the Foreign Investment and Technology Act 1981 was enunciated. The salient features of the act were: (a) industrial units set up under the Act would not be nationalized; and b) industrial units set up under the act would receive the same facility, concession and protection as provided by the Industrial Enterprise Act, 1982. Foreign investors were permitted to have majority of shares in medium scale industries but were permitted 100 % in large–scale industries, with more than Rs. 10 million investments in fixed assets.

Various facilities and provisions were included in the Act for instance, production oriented industries with 25-50 % value-added would be granted full income tax exemption for five years. Analogously, tourism-based industries were granted full income tax exemption for a minimum of 7 years and the industries set up in underdeveloped areas were exempted from excise duty for a minimum of 5 years. Moreover, convertible foreign currency facilities were to be provided to joint venture industries for importing machineries, equipments and tools, spare parts and components, raw materials as well for technical consultancy and management fee. Still, the Act restricted any foreign investment and transfer of technology to small and cottage industries to keep the sector solely for Nepalese entrepreneurs.

4.1.2 Foreign Investment and Technology Transfer Act, 1992

According to Foreign Investment and Technology Transfer Act (FITTA) of 1992, the foreign investment means:

- Investment in share (equity)
- Reinvestment of the earnings derived from the investment in share (equity), and
- Investment made in the form of loan or loan facilities.

According to Act, "Technology Transfer" means any transfer of technology to be made under an agreement between an industry and a foreign investor on the following matters:

- Use of any technological right, specialization, formula, process, patent or technical know-how of foreign origin.
- Use of any trademark of foreign ownership.
- Acquiring any foreign technical, consultancy, management and marketing service.

By the Act, "Foreign Investor" means any foreign individual, firm, company or corporate body involved in foreign investment or technology transfer including foreign government or international agency.

Foreign Investment and Technology Transfer Act lays down the basic law governing foreign investment in the country. The FITTA has undergone its first amendment in 1996 aiming at making the environment of industrial investment more congenial, straightforward, encouraging and transparent.

According to FITTA, 1992 permission is given to the foreign investor to repatriate the following income outside the country:

a) Amount received by the sale of the share of foreign investment as a whole or any part thereof.

b) The amount received as profit or dividend in lieu of the foreign investment.

c) The amount received as the payment of the principal of and interest on any foreign loan.

Some other major features of FITTA, 1992 are as follows:

a) Provision Relating to Visa

The provisions relating to Visa according to FITTA, 1992 are as follows:

1) A foreign national visiting the kingdom of Nepal in connection with undertaking any study or carrying out any research with the objective of making investment in the kingdom of Nepal shall be provided a non tourist visa for upto six months.

2) A foreign investor or dependent family or authorized representative of such a foreign investor and dependent family of such authorized representative shall for the purpose of stay in the Kingdom of

Nepal be provided a business visa until the foreign investment is retained (Amended by the First Amendment).

3) Provided that a foreign investor who, at a time, makes investment in an amount no less than one hundred thousand United States dollar or in convertible foreign currency equivalent thereto, and his dependent family shall be granted a residential visa until such investment is retained.

b) Settlement of Disputes

FITTA, 1992 provides separate dispute settlement procedures which are as follows.

1) If any dispute arises between a foreign investor, national investor or the concerned industry, the concerned parties shall be required to settle the dispute by mutual consultations in the presence of the department.
2) If the dispute could not be settled in the manner as referred to in subsection (1) above, it shall be settled by arbitration in accordance with the prevailing arbitration rules of the Untied Nations Commission on International Trade Law (UNCITRAL).
3) The arbitration shall be held in Kathmandu, the laws of Nepal shall be applicable in the arbitration.
4) Notwithstanding anything contained in sub sections (1), (2) and (3) above, disputes arising in regard to foreign investment made in the industries with investment as prescribed may be settled as mentioned in the foreign investment agreement.

4.1.3 Procedures for Repatriating Facilities

For the repatriation of the sale of shares of the foreign investor, he/she or the concerned company must apply to the DOI for recommendation to the central bank.

4.1.3.1 Documents Required for the Repatriation of Sales of Shares

a) Proof of investment and number of shares owned.
b) Letter from the company stating the completion of the transfer of the related shares duly certified by the Company Registar's Office or such competent body.
c) Prior approval of DOI, if the share was transferred to any foreign national.
d) Tax Clearance Certificate.
e) Custom declaration from and the approval letter if the investment was made in the form of plant, machinery and equipment.
f) Copy of the Board of Director's Resolution.

4.1.3.2 Documents Required for Applying to the DOI to Get Recommendation for Repatriation of Dividend

a) Documentary proof of investment made which is issued by the commercial bank. This document is needed only for the first time and again only when further investment is made by the investor,
b) Custom declaration certificate of the import of plant machinery and equipment if the investment by the foreign investor has been made in the form of capital equipment.
c) Auditor's report including balance sheet and profit and loss account.
d) Tax Clearance Certificate.
e) Proof of dividend declaration.

4.1.3.3 Documents Required for Repatriating Loan and Interest

a) Certificate from the commercial bank regarding the transfer of loan amount into Nepal,
b) Custom declaration certificate and invoice of the plant machinery if the loan was obtained in the form of machinery,

c) Letter of approval of the loan agreement,

d) Tax Clearance Certificate.

4.1.3.4 Documents Required for Repatriating Technology Transfer Fees

The industrial unit with approved technology transfer agreement, trademark, license agreement, management agreement, technical assistance agreement can apply to the DOI for the transfer of fees as per the agreement. The company has to submit the calculation of the amount due to the foreign technology transfer certified by the auditor along with the certificate of payment of income tax on royalty as per the prevailing tax rate.

4.1.3.5 Documents Required for Repatriation of the Salaries and Allowance of the Expatriates:

a) Work permit issued by the Department of Labour.

b) Document showing the amount of salary and allowance received during the period for which the repatriation is sought.

4.1.4 Visa Arrangement

4.1.4.1 Types of Visa

There is provision of seven categories of visa in the Immigration Act 2049 and Immigration Regulation 2051. There are.

a) Diplomatic Visa

b) Official Visa

c) Study visa

d) Non-tourist visa

e) Business visa

f) Tourist visa

g) Residential visa

But only the last four categories of Visa (d-g) are relevant to foreign investors and expatriate personnel.

4.1.4.2 Charges for Obtaining the Visa

a) Tourist Visa

A tourist can be granted tourist visa for upto 150 days in one visa year (Jan. 1 to Dec. 31)

The charges for this category of visa are as follows:

- Single entry (first time in one visa year), for 60 days duration, the fee is US$ 30 or equivalent. Any extension of such visa will be charged US$30 or equivalent for a period of 30 days.
- Multiple entries for one visa-year duration, one off payment, the fee is additional US$ 50 or equivalent
- Single entry (Re-entry in Nepal), for 30 days duration, the fee is US$ 30 or equivalent. However, if the tourist had not spent more than 15 days in earlier visit, no visa fee will be charged.

But citizens of China and SAARC countries will not be charged visa fees. Similarly, any visitor spending less than 3 days in Nepal will not be charged fee.

b) Non-Tourist Visa for Carrying Out the Feasibility Study

b.1 Non-Tourist Visa

Foreign visitors, wishing to undertake research and study with a purpose of investing in Nepal may be granted a non-tourist visa by the Department of Immigration for a maximum period of 6 months on recommendation of the DOI. The charge for this category of visa is as follows:

- If issued at the port of entry US$ 25 for 30 days.
- In other situation, US$ 60 per month.

b. 2 Non-Tourist Visa for Expatriates

If required skilled manpower is not available locally, industry can employ foreign nationals by obtaining work permit. Such expatriate personnel working in the industries will be granted a non-tourist visa for duration of one year at a time on recommendation of DOI and Department of Labor.

The charges for this category of visa are:

- First year US$ 60 per month.
- Second year onwards US$ 100 per month .

C) Business Visa

Foreign investors and/or his/her authorized representative and their dependents will be granted a business visa for upto a period of five years at a time on recommendation of DOI.

The charges for this category of visa are;

- For a period of one year and multiple entry -US$ 100.
- For a period of five years and multiple entry- US$ 250.

D) Residential Visa

Foreign investor making an investment equivalent to more than US$100,000 an one time and in convertible foreign currency, will be granted a residential visa on recommendation of DOI. This visa can be granted for one year at a time.

The charge for this category of visa is US$ 200 per year for the first time and US$ 100 per year for each renewal.

4.1.4.3 Land Facilities

Pursuant to the Muluki Ain's (Country Code) provision in the section 3 of chapter on Adal, any foreigners are not allowed to possess any land in any form except otherwise permitted by the government. However, in case of foreign investments, such restrictions are related. Any business parties who incorporate a company in the kingdom of

Nepal has rights to hold land without the Government's permission as the company by law is treated to be the juridical person of Nepalese nationality and hence the company will enjoy the similar rights as Nepali does. Moreover, Pursuant to the section 7.2 of the industrial policy industries are given priority for government land and sites in industrial districts for the establishment of the industries. Further, a one-window committee formed under the Foreign Investment policy is responsible for providing facilities, such as registration, land, electricity, water and facilities on taxation etc., for industries established or to be established through foreign investment. Therefore, notwithstanding to the Adal no. 3 of Muluki Ain, there is no theoretical or practical problem for a company owned by a foreign investment to hold land in Nepal.

4.1.4.4 Convertible Foreign Exchange Facilities

The Act has provided with the convertible foreign exchange facility for importing necessary equipment and tools, spare parts and components, auxiliary raw material and chemical required for the operation of an industry or for the sake of technical consultancy, technical assistance, service fee, management fee, patent duty, market research, industrial promotion, sales promotion etc.

4.1.4.5 Procedural Arrangements

Under FITTA, government approval or permission is required for foreign investment or technology transfer. Pursuant to 12 of Industrial Enterprise Act, a high-level Industrial Promotion Board has been established under the chairmanship of the Minister or State Minister for industries to deal with matters concerning the approval of foreign investments under FITTA. For the establishment of either 100 % foreign owned enterprises or joint venture industry on a prescribed form along with a detailed feasibility report. The application form calls for information on project objectives, location, total project cost, source of finance, plant capacity, equipment, machinery, raw material requirements and the other specific contribution to be made by the foreign investor and the local investor.

The project proposal is assed by the Department of Industry and operation permission is granted to the industries with the fixed asset investment upto five hundred million rupees within 30 days from the date of application. In case of the fixed asset investment exceeding 500 million rupees, the DOI submits its recommendation to the Industrial Promotion Board for approval. The DOI notifies the applicant about the decision of the Board within 30 days form the receipt of the application. In granting the permission for investment, the DOI specifies facilities and concessions the investor is entitled to.

After the issuance of license, the applicant is required to apply for the registration of company with the company registar's office within 35 days form the date of receipt permission.

4.1.5 Board of Investment (BOI)

The Board of Investment was formed in Nepal on 27 December 2001 under the chairmanship of the Prime Minister. The Board was set up in order to promote investment and make it more transparent and reliable. The other objectives of Board include: formulation of new policies by reviewing the existing investment policy, maintaining coordination between various government and non-government organizations for the promotion of investment, pinpointing the areas of priority sector for investment promotion, monitoring the activities associated with investment promotion and providing directives to the concerned department to boost up investment.

CHAPTER V
TREND AND STRUCTURE OF FOREIGN DIRECT INVESTMENT IN NEPAL

5.1 Trend of FDI in Nepal

This chapter is mainly concerned with trend and structure of foreign direct investment (FDI) in Nepal that has been analyzed into sector, year and country wise categorization of FDI inflow from 1989/90 to FY 2006/07

FDI trend may be positive or negative in general. Since Nepalese economy is passing through a critical phase of low level equilibrium trap circumscribed by poverty and stagnation, and conflict and recession, FDI trend seems to be more fluctuating during the last 10 years. As political stability and peace are the sine quo non for attracting grater volume of FDI in Nepal, Nepalese economy has suffered from serious structural constraints accompanied by unprecedented political turmoil since many years. Present scenario reveals that Nepal has not been able to attract desirable size of FDI inflow within the country. Statistics show that FDI in Nepal is relatively on small proportion compared to other South Asian Countries. Available data for FDI reflect those 1218 foreign investment projects were approved in Nepal comprising all categories of industries, worth a total of Rs. 96.74 billion. The total fixed capital is estimated to be Rs. 80.10 billion, while the total foreign direct investment (FDI) marked Rs. 32.07 billion as of July 2007. FDI provided employment to 112889 people. The Joint Ventures of India, China US. Japan, Germany and South Korea are prominent in the structure of FDI. Indian Joint Ventures accounted for 43.73% of total foreign investment.

New areas for foreign investment are opened up through the amendment of Foreign Investment and Technology Transfer Act, with an objective of providing necessary permission, services and facilities to the foreign investors through one door system. Foreign Investment Promotion Committee Working Manual, 2005 is under implementation.

Nepal is a rich country in sense of natural resources but Nepal's rich natural and human resources have not been optimally utilized, thereby referring to Nepalese people as "Poor in a rich country". Foreign Investment and Technology Transfer is essential for leading the nation's economic system towards the attainment of self- dependency and making it a robust, firm, dynamic and competitive through the optimum utilization of available natural and human resources.

The foreign investment helps bring capital, modern technology and managerial and technical skills, opens access to international market and promotes competitive business culture. Such improved business culture contributes significantly to the national development leading towards self- reliance and self- dependence, through the expansion of industrial development and internal revenue base.

5.1.1 Year Wise Flow of Foreign Direct Investment in Nepal

The trend of year wise flow of foreign direct investment in Nepal is erratic and unpredictable. The chart-1 plotted with the investment flow as per the record of DOI from 1989 to 2007 A.D. reveals such oscillatory trend. This chart shows that the magnitude of FDI leveled Rs. 466.84 million in FY 1989/90 which increased to Rs. 2453.12 million in FY 2006/07. According to the data of DOI record, the highest foreign investment flow after 1990 was found to be Rs. 3102.56 million in FY 2000/01 followed by Rs. 3083.67 million in FY 1992/93, Rs. 2764080 million in FY 2003/04, Rs. 2606.31 million in FY 2003/04, Rs. 2606.31 million in FY 2005/06 and Rs. 2453.12 million in FY 2006/07.

In terms of number of industries there were 59 industries based on FDI upto July 1989. The FY 2006/07 recorded the highest number 121, followed by 116 in FY 2005/06, 96 in FY 2000/01, 77 in FY 1997/98, 77 in FY 1996/1997 and so on, which has been shown in chart -2.

Chart: 1

Trend of Foreign Direct Investment in Nepal from FY 1989/90 to FY 2006/07

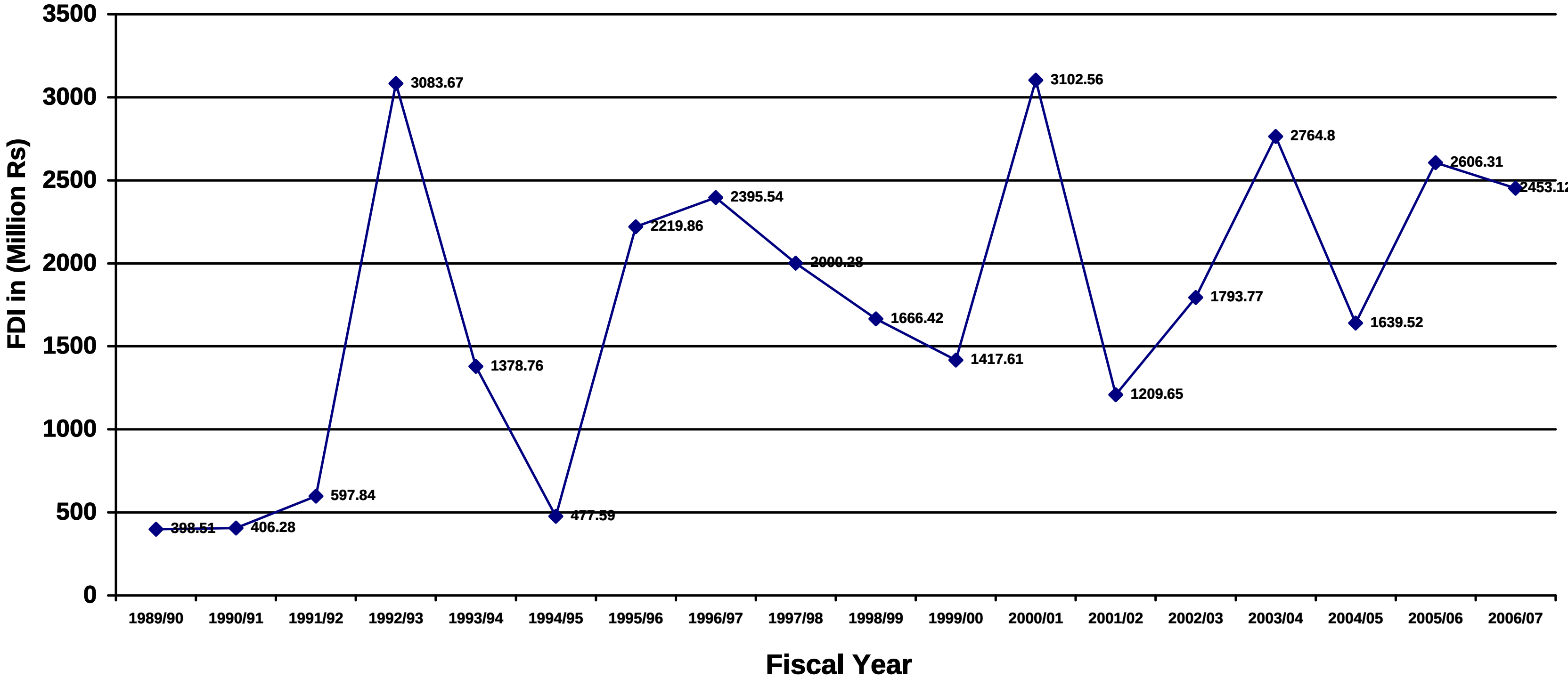
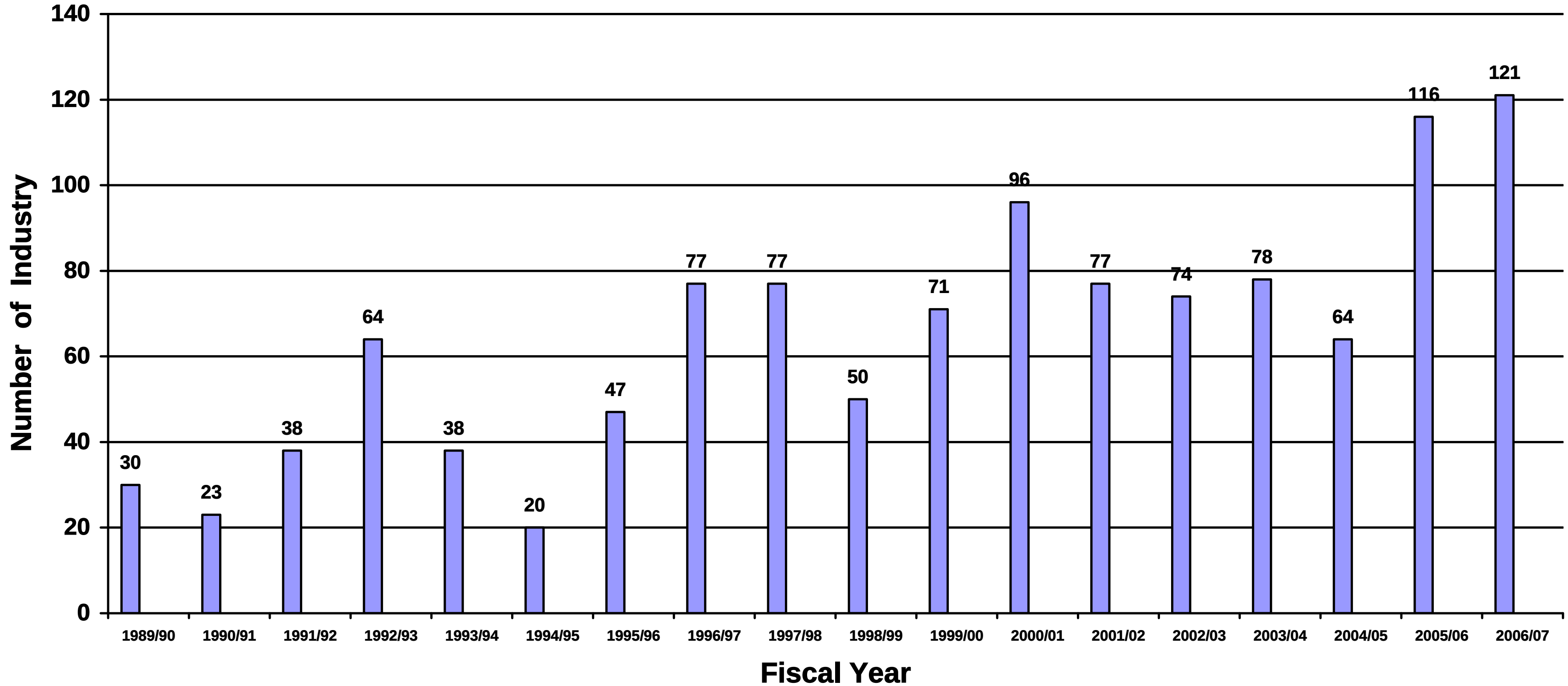


Chart: 2

Trend of Industries Established Under Foreign Direct Investment In Nepal from FY 1989/90 2006/07



5.1.2 Category-wise Flow of Foreign Direct Investment

Categorically, there are seven industries which include agriculture, manufacturing, tourism, construction, energy-based, service and mineral-based. The amount of foreign investment in each of these industries are shown in the table 1.

Table: 1

Number of Industries Approved for Foreign Investment by Category (up to FY 2006/07)

Rs. in million

Category	No. of industries	Total project cost	Total fixed cost	Foreign investment	Employment
Agriculture	15	440.15	385.20	101.76	1023
Construction	23	1186.93	909.77	691.01	1544
Energy based	19	19814.30	18149.77	3432.45	4899
Manufacturing	522	39513.62	28588.56	13815.35	66067
Mineral	4	1163.14	1073.32	55.98	1257
Service	331	18323.23	15564.73	9104.58	20896
Tourism	304	16299.90	15436.81	4874.6	17203
Total	1218	96741.90	80108.15	32075.19	112889

Source: Department of Industry, Government of Nepal, July 2007.

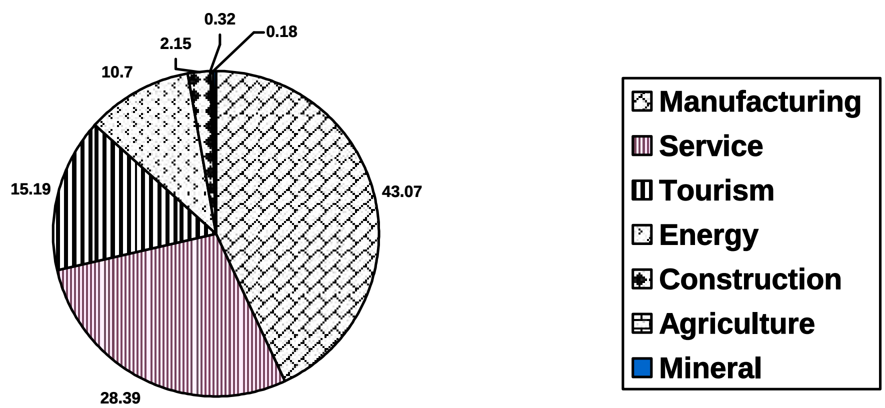
The structure of FDI reflects that the number of total industries under different categories marked 1218 in Nepal during FY 1989/90 FY 2006/07 Table 1 reflects that the magnitude of FDI was highest in manufacturing sector that marked Rs. 13815.35 million, which was 43.07% of the total. With Rs. 9104.58 million (28.39%) services sector occupied the second position to attract FDI in Nepal. In the context of FDI, tourism sector received the third position that leveled Rs. 4874.06 million (15.19%), while energy sector occupied the fourth position to attract FDI to the tune of Rs.

3432.45 million (10.7%), construction, agriculture and mineral sector received the lowest priority in obtaining FDI.

The highest employment was provided by manufacturing sector i.e. 66067, which was 58.52 % of the total employment received through FDI. The contribution of service sector to employment was 18.51%, while the share of tourism sector to employment was 15.23% followed by energy (4.34%), construction (1.37%), mineral (1.11%) and agriculture (0.9%)

Chart: 3

Percentage Distribution of FDI by type of industries upto FY 2006/07



A look at the table -1 and chart 3 reveals that manufacturing sector has commanded 43.07% of total foreign investment inflow, 42.86% of total number of industries, 35.69% of total fixed cost and 40.84% of total project cost. This industry alone constitutes 58.52% of total employment generation.

5.1.3 Sector-wise Flow of Foreign Direct Investment

Table: 2

Number of Industries Approved by Sector (up to FY 2006/07)

Sector	No. of industries	Total project cost	Total fixed cost	Foreign investment	Employment
Manufacturing	497	37277.08	27027.84	11665.25	64590
Food Beverage and Tobacco	*76*	*9182.59*	*7969.80*	*2207.62*	*9143*
Textile and Rea. Garment	*177*	*8900.17*	*5611.00*	*3244.17*	*35570*
Wood and wood product	*8*	*116.36*	*89.85*	*41.52*	*1440*
Paper and Paper product	*23*	*1824.48*	*1542.44*	*334.00*	*944*
Chem and Pl. product	*89*	*7158.25*	*5222.57*	*2953.96*	*7075*
Non- Met Mi. product	*20*	*3831.63*	*2314.40*	*116.03*	*3188*
Basic Metal. product	*25*	*2199.98*	*1443.92*	*693.00*	*1971*
Febric Metal M/C and	*55*	*3180.12*	*2206.84*	*854.32*	*3803*
others manufacturing units	*21*	*883.50*	*627.02*	*220.62*	*1456*
Agriculture and Forestry	14	1682.05	1521.27	461.57	850
Electricity, Water, Gas	23	19997.77	18212.09	3503.56	5146
Construction	37	1887.65	1404.44	1161.62	1957
Hotel and Resort	281	16180.07	15230.39	4754.52	16554
Transport and communication	31	4226.68	2924.43	1687.94	5225
Housing and Apartment	18	275.73	117.50	162.87	1694
Service industries	320	15214.24	13670.20	8677.87	16873
Total	1218	96741.27	80108.15	32075.19	112889

Source: Department of Industry Government of Nepal, FY 1989/90-FY 2006/07.

Table -2 indicates that there were 497 manufacturing units receiving FDI Manufacturing sector received top priority to attract FDI to the level of Rs. 11665.25 million (11.6 billion), which was 36.37% of total during the period FY 1989/90 to FY 2006/07.

The composition of manufacturing sector consists of nine components in Nepalese context. They are namely food beverage and tobacco, textile and readymade garments, wood and wood product, paper and pulp product, chemical and plastic product, non- metallic MI product, basic metal product, fabric metal and other manufacturing units.

Textile and readymade garment has received 177 FDI project with the total cost of Rs. 8900.17 million. Its share in total FDI is estimated 10.12 % while 27.81 % in total FDI in manufacturing sector. Thus, this sector has been largest FDI recipient that is commented unusual and unequal FDI distribution. It raises a question "why'. The major reason is "quota facility for textile and garment provided by USA and Germany to Nepal for her industrial development on the basis of least developing country".

In the context of FDI, service industries that account Rs. 8677.87 million occupied second position, which was 27.05% of the total FDI during the same period. Hotel and Resorts received Rs. 4754.52 million FDI (Third position), 14.82% of total FDI. The share of FDI in electricity, water and gas was Rs. 3503.56 million, which was 10.92% of the total, while the contribution of FDI in construction was Rs. 1161 .62 million, which was 3 .63% of total FDI . Similarly, transport and communication received Rs. 1687.94 million (5.26%), while the contribution of FDI was lowest in agriculture and Forestry (1.44%), and Housing and Apartment Sectors (0.5%) .

The highest number of employment was provided by manufacturing sector, which was 57.21% of total employment in foreign investment projects followed by service industries (14.94%), hotel and resort (14.66%) transport and communication (4.62%), electricity, water and gas (4.59%), construction (1.73%), housing and apartment (1.50%) and agricultural and forestry (0.75%). of the total employment in manufacturing sector, the share of textile and readymade garment along was 31.50% in the total employment through FDI during FY 1988/89 to FY 2006/07.

5.1.4 Flow of Foreign Direct Investment in Nepal

Table: 3

Flow of Foreign Direct Investment in Nepal under Different Periodic Plan

Rs. in Million

Duration	No. of projects	%	Total capital investment	%	Total FDI	%	Total employment	%
Before eighth plan	150	12.3	12235.84	12.65	186.47	0.58	2890	2.56
Eighth plan	245	20.1	41853.45	43.26	9555.42	29.80	38372	33.99
Ninth Plan	373	30.7	24805.79	25.64	9432.2	29.40	21796	19.31
After Ninth Plan	450	36.9	17846.19	18.45	12901.1	40.22	49831	44.14
Total	1218	100	96741.27	100	32075.19	100	112889	100

Source: Computed from DOI Data.

The stock of FDI before eight plan was recorded to be low than in the post- liberalization period. Table-3 reveals that structure of FDI in the different plans. This table shows that stock of FDI in the pre- liberalization period was found to be 186.47 million which is only 0.58% of total FDI. Before eight Plans there were only 150 industries based on foreign direct investment with the total capital investment of Rs. 12235.84 million which is only 12.65% of total capital investme and total employment generation through foreign collaborated projects in the period was estimated to be 2890.

During the Eighth Plan, there were 245 industries registered with the capital investment of Rs. 41853.45 million. Which is 43.26% of total capital investment approved upto march 2007. Similarly foreign investment participation in these projects was equal to Rs. 9555.42 million (29.80% of total FDI). Total employment generation through foreign collaborated projects in the period was estimated to be 38372 (33.99% of total)

During the Ninth Plan, there were 373 industries (30.7% of total FDI industries registered with the capital investment of Rs. 24805.79 million (25.64% of the total) and foreign investment of Rs. 9432.2 million (29.4% of total FDI). In the period, 21796, job seats for local people were estimated to be created by the operation of these registered projects.

After the Ninth plan and up to March-2007 (Falgun 2064), 450 projects of foreign collaboration have been registered. These projects are expected to mobilize the capital investment and foreign investment equivalent to Rs. 17846.19 (18.45% of the total) and Rs. 12901.1 (40.22% of total FDI) million respectively. Subsequently, these projects if brought into operation would create job opportunities to 49831 people (44.14% of total employment).

5.1.5 Country wise Flow of Foreign Direct Investment in Nepal

FDI sources by country divergent as shown in Appendix II are long listed of 52 countries. India investing in 359 projects (29.47% of total FDI projects approved) with Rs. 14025.91 million (43.73% of total FDI) has become the top of them with largest number of projects. Appendix II shows that the number of Chinese Joint Ventures was second highest (151) in Nepal, followed by Japan (125), U.S.A (114), South Korea (71), U.K (54), Germany (50) France (29), Netherlands and Switzerland 23 each, Hong Kong (15), Italy (14), Canada (13) Bangladesh (13) Pakistan (12), Singapore

(12) and other countries (140) . The magnitude of FDI from China was Rs. 3299 million (10.23% of total FDI) and U.S.A was Rs. 4584.90 million (14.3% of total FDI) followed by Norway Rs. 1061.33 millions (3.30%), Japan Rs. 1041.08 million (3.25%), S. Korea Rs. 1026.33 million (3.20%), Bri- Virg. Is Rs. 961.43 million (3%), U.K Rs. 881.88 million (2.75%) Canada Rs. 667.01 million (2.08%), Germany Rs. 648.72 million (2.02%), Hong Kong Rs. 525.24 million (1.64%) and other countries Rs. 3352.36 million (10.45% of total FDI).

Indian Joint Ventures provided the highest employment through FDI in Nepal, which was 40.48% of total employment. The other major countries in terms of FDI that provided considerably higher number of employment were the USA (9.22 %), China (9.02 %), U.K. (5.44%), Japan (5.27%), Bangladesh (3.34%), S. Korea (3.28%), Germany (2.6%), Pakistan (2.09%), Hong Kong (1.84 %), New Zealand (1.77%) and other countries (15.65%).

5.1.6 Type and Scale-wise Flow of Foreign Direct Investment in Nepal

5.1.6.1 Type -wise Flow

By type the flow of foreign direct investment consists in the form of equity, equity plus technology transfer and technology transfer only. The data reveals that the inflow of foreign investment in Nepal has mostly been in the form of equity investment that runs in 1111 industries in which 442 pertains to manufacturing (39.8% of the total), 321 to service (28.9%) , 292 to tourism (26.3%), 19 to energy based (1.71%), 21 to construction (1.9%) , 14 to agro-based (1.26%) and 2 to mineral based (0.18%). When total 1218 industries are distributed into categorical form, manufacturing industries consists of 522 numbers which is 42.85% of total industries approved for foreign investment .

Table: 4

Flow of Foreign Direct Investment in Nepal by Type of Industries (Upto FY 2006/07 FNM)

Category	No. of Industries	Type			Scale		
		Equity Invest.	Eqt. Invest, & tech. Tran	Tech. Transfer	Small	Medium	Large
Manufacturing	522	442	39	41	353	109	60
Agro Based	15	14	0	1	10	5	0
Energy Based	19	19	0	0	2	4	13
Construction	23	21	2	0	13	7	3
Mineral Based	4	2	1	1	2	0	2
Service	331	321	3	7	275	36	20
Tourism	304	292	6	6	251	23	30
Total	1218	1111	51	56	906	184	128

Source: Department of Industry, Government of Nepal, FY 2006/07.

Likewise agro based, tourism, service, construction, energy and mineral based consists of 15, 304, 331, 23 19 and 4 industries respectively.

Table - 4 shows that in 522 manufacturing industries 442 i.e. 84.67 % of manufacturing industries run with equity investment, 39 out of 522 i.e. 7.47 % with equity plus technical investment and 41 out of 522 i.e. 7.85 % with technical investment only. Similarly in agro-based industries, equity investment has occupied 93.33 % of total agro industries and remaining 6.67 % by the technical investment only. In energy based industries, equity investment has occupied 100 % of total energy-based industries. Equity investment in service industries constitutes 96.98% whereas the share of equity plus technical transfer and technical transfer only is negligible with 0.9 % and 2.11 % respectively. Tourism industry has also been dominated by the equity investment. Statistically, 292 out of 304 industries i.e. 96.05 % are in the form of equity investment and in remaining 12 industries, 6 run with equity plus technical and 6 with technical only. In mineral based industries, 2 out of 4 mineral based industries i.e. 50% are in the form of equity investment against 25% of each equity plus technical and technical only. In construction industries, equity investment constitutes 91.3 % whereas equity plus technical constitutes remaining 8.7% and there is no technical investment only.

5.1.6.2 FDI by Size of Industry

In Nepal, the inflow of foreign direct investment has mostly been concentrated in small scale industries in which there are 906 total industries, which is equal to 74.38%. The medium and large-scale industries occupy second and third place respectively by apprehending 184 and 128 numbers of industries. As per the data in the table - 4, manufacturing industries consist of 353 small, 109 medium and 60 large scale industries. Likewise, the share of other industries such as agro-based construction, service and tourism with respect to small scale industries is found to be the highest except mineral based and energy based industries. In total 15 agro based industries 10 of them fall under small-scale, 5 to medium and there is no inflow of foreign investment in the large-scale agro-industries at all. In energy-based industries, the large-scale investment has taken the lead with the investment for 13 numbers of industries while investment in case of small and medium scale industries has gone to 2 and 4 projects respectively.

In service industries the concentration of foreign investment has been found in small scale projects followed by medium and large-scale industries. In 331 service industries small scale consists of 275 numbers of projects (83.08 %), whereas medium and large scale consists of only 36 (10.87 %)

and 20 (6.04 %) numbers of projects. Likewise, in tourism industries, small-scale industries take the lead against medium and large scale industries by claiming 251 projects (82.56 %) out of 304 projects and medium and large scale industries share only 7.56 % and 9.87 %, of the total tourism industries respectively.

As for the mineral based industries, there is no investment flow into medium scale projects while large and small scale industries represent 50% of each. Foreign investment in construction industries consists of 13 small scale (56.52% of total construction industries), 7 medium - scale (30.44%) and 3 large scale (13.04%).

In conclusion, the magnitude of FDI leveled Rs. 466.84 million in FY 1989/90 which increased to Rs. 2453.12 million in FY 2006/07. According to the data of DOI records, the highest foreign investment flow after 1990 was to be found Rs. 3102.56 million in FY 2000/01. Till now, Nepal has been able to attract FDI of only Rs. 32075.19 million which is very low in comparison to other countries. Available data for FDI reflects that 1218 foreign investment projects were approved in Nepal comprising all categories of industries, worth a total of 96.74 billion. The total fixed capital is estimated to be Rs. 80.10 billion as of July 2007. FDI provided employment to 112889 people. The Joint Ventures of India, China, U.S., Japan, Germany and South Korea are prominent in the structure of FDI. Indian Joint Ventures accounted for 43.73% of total FDI.

Categorically, there are only seven industries based on FDI in Nepal which include agriculture, manufacturing, tourism, construction, energy-based and service. The inflow of FDI was found highest in manufacturing sector that marked Rs. 13815.35 million (43.07%) while FDI inflow was found lowest in mineral-based that marked Rs. 55.98 million as of July 2007.

By type, the flow of foreign direct investment consists in the form of equity, equity plus technology transfer and technology transfer only. According to DOI, the inflow of FDI in Nepal has mostly been in the forms of equity investment that runs 1111 industries followed by technology transfer (56) and e equity investment and technology transfer (51).

Scale wise flow of FDI reflects that most of FDI has mostly been concentrated in small scale industries in which there are 906 total industries followed by medium scale industries (184) and large scale industries (12.8).

CHAPTER VI

NEED AND PROSPECTS OF FOREIGN DIRECT INVESTMENT IN NEPAL

6.1 Need of FDI in Nepal

6.1.1 Background

Foreign investment has been accorded very high priority for industrial development in Nepal. Government of Nepal has pursued open and market oriented liberal policy for national economic development. In line with this policy, new Industrial Enterprises Act and the Foreign Investment and Technology Transfer Act have been promulgated in 1992. Various procedures have been streamlined and simplified to make them transparent and to ameliorate the investment climate.

Nepal's rich natural and human resources have not been optimally utilized. Foreign investment and technology transfer is essential for leading the nation's economic system towards the attainment of self-dependency and making it a robust, firm, dynamic and competitive through the optimum utilization of available natural and human resources. The foreign investment helps bring capital, modern technology, and managerial and technical skills, opens access to international market and promotes competitive business culture. Such improved business culture contributes significantly to the national development leading towards self-reliance and self-dependence, through the expansion of industrial development and internal revenue base. The Need of FDI in Nepal is unquestionable as there is acute gap in between private investment and saving, on the one hand and government expenditure and revenue on the other. This situation has entailed the critical situation of low level equilibrium trap. To come out of this trap, Nepal must have enough dose of investment to break the inelasticity in the production demand and national saving and thereby the vicious circle of poverty operated from both demand and supply side.

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

Foreign direct investment is more preferred than other means of foreign finance such as concessionary commercial loans and unrequited transfers. There are good reasons to believe that FDI is preferred to other types of investment flow. One convincing argument is that FDI consists of a package of capital, technology, and market access that tends to go to those manufacturing sectors that enjoy actual or potential comparative advantage. On the other hand, official flow and ever commercial loans are often tied with social overheads and sectors of long gestation period that do not enjoy comparative advantage in the developing recipient countries.

The inflow of FDI would give rise to economies of scale and higher productivity and create linkage effects. Moreover, there are number of financial advantages of FDI over other types of flow for developing recipient counties. In case of FDI, there is also a closer match between the maturing structure of earnings and repayments and hence the liquidity problem is avoided, which arises for other types of flow using short-term loans to finance long-term projects. With FDI, both the commercial risks and the exchange rate risks are passed on the investor rather than having to be borne by the host government.

There is also a theoretical rationality over the preference for private investment rather than the investment by the public sector. In the elementary macroeconomic literature, the public investment is supposed to crowd out private investment by creating fisher effect, investment by creating fisher effect, interest rate effect and exchange rate effect. These effects increase the cost of capital and thereby produce the disincentives for private sector involvement. Further, the public sector cannot allocate resources as optimally and efficiently as private sector and as such raises the cost of production and thereby lowers the international competitiveness for export of the product. Again when government lacks fund and borrows from outside for investing in development of long term projects of yielding returns after a long period immediately puts pressure on the price level through increasing money supply so the needs of FDI can be summarized as follows:

(I) To Fulfill Resources Gap

Table: 5

Investment Saving Gap as Percentage of GDP(1975-2007)

Extent of resource gap in Nepal (In %)			
Year	Investment/GDP	Saving GDP	I-S
1975	15	10.4	4.6
1980	19.5	11.8	7.7
1985	21.9	13.4	8.5
1989	21.8	11.4	10.4
1991-1995	22.54	12.7	9.84
1996-2000	24.23	13.92	10.31
2000-2001	22.34	11.66	10.68
2001/2002	19.18	9.49	9.69
2002/2003	19.65	8.56	11.09
2003/2004	22.04	11.75	10.29
2004/2005	23.05	11.56	11.49
2005/2006 (R)	22.25	7.91	14.34
2006/2007(P)	20.38	9.35	11.03

Source: Computed from Economic Survey, 2006/07

P = Preliminary,

R = Revised.

Nepal, being one of the underdeveloped countries of the world, has been facing the acute problem of resource gap from the very beginning. This table reveals the rising extent of resource gap form 1975 to 2001. In 1975, resource gap was 4.6 % of GDP, while in 2000/01, it reached to 10.68. The gap widened sharply after 1990s. The average gap between the period 1991-1995 and 1996-2000 was found to be 9.84 and 10.31 respectively. The reason behind the widening gap is higher demand for investment and lower rate of saving plus rising government and more or less stagnant revenue field.

Elementary macroeconomics relates the resource gap with foreign exchange gap. For the illustration, a macro system in a four sector economy is equilibrium when:

$$S+T+M = I+G+X$$

$$\text{Or } (G-T) + (I-S) = (M-X)$$

This relation indicates that the sum of net public and private investment directly spill over into the foreign exchange gap. Larger the resource gap, the wider the foreign exchange gap tends to be. To correct the problem of foreign exchange gap, Nepal must either reduce the public and private expenditure or increase public or private saving or encourage the export and discourage the import. But it is noteworthy that the government expenditure is always of rising nature and hence cannot be reduced in a remarkable degree while the reduction in private investment is not rationale as we have the gap in desired and actual stock of capital. So, it is necessary to encourage the export and cut luxury imports or to borrow from outside or to finance through the amount received as grants in order to fill or bridge the resource and exchange gaps. The financing of foreign exchange for the import of machine and equipment, tools and raw materials through borrowed money would solve the problem for short term but in the long- run it would further aggravate the problem as these loans are to be paid back with interest irrespective of the profits made out of these investment. To depend excessively on foreign aid for bridging the gaps would affect national integrity and Sovereignty on the one hand and on the other the aid- financed projects are of long- term nature characterized by low level of return.

Therefore, there is the shifting statistical evidence from loan and grant to the foreign private investment. Foreign investment brings with them capital, technology, management and other necessary qualitative and quantitative instruments, which expand the productive capacities of the host economy and links into the international economy. Inflow of FDI also serves to reduce the unemployment, violence and other many social evils. Thus, FDI is regarded as main engine to accelerate the growth rate through export promotion along with building up of productive assets and thereby enabling the country to break the vicious circle of poverty.

II) To Fulfill Trade Gap

Table: 6

Trend of Trade Gap in Nepal from FY1988/89 to FY 2006/07

S.N.	Description	1988-1990	1990-95	1995-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
1	Export/GDP	4.99	8.76	10.02	22.56	17.74	15.70	16.68	14.58	13.60	12.48
2	Imports/ GDP	17.97	24.38	29.19	33.24	27.13	25.34	25.21	24.54	23.82	19.55
3	X-M/GDP	-12.96	-15.62	-19.17	-10.68	-9.39	-9.64	-8.53	-9.96	-10.22	-7.07

Source: Computed from survey, 2006/07

p = Preliminary, R= Revised

Nepal is facing the problem of trade deficit from a long time back due to larger volume of imports and relatively low exports. The trade direction in Nepal reveals that it is largely Indo-centric in both import and export in the recent years. The export of Nepal is highly dominated by drugs and garments, followed by other cheap raw materials and foods. Considering these facts, Nepal's present trade problem is not only to bridge the trade gap but also to have structural changes so that the sufficient foreign exchange can be generated along with stable.

In table- 6, the trade gap scenario from 1988 to 2007 has been presented. The table shows the rising trend of trade deficit from the period 1988 to 1990, it was 12.98 % of GDP, which in the period of 1991-1995 came to be 15.62 % and subsequently in between 1996 to 2000, it was found to be 19.17 % of GDP. Similarly, trade gap in FY 2002/03 was 9.64 % of GDP while in FY 2005/06, it increased to 10.22 %.

Nepal has adopted many policies and incentives with the view of encouraging exports and thereby to reduce the trade gap. However, devaluation has not improved the trade gap rather it has been means to divert trade towards India due to the pegged exchange rate with this country. Further, the devaluation has caused the trade gap to be wider due to making import expensive and export is more or less stagnant due to export inelasticity. Realizing these facts, the government after reinstatement of democracy in 1990 has opened its economy for private domestic and foreign firms to break the supply side bottlenecks and thereby increases the economy's competitiveness in the international markets. FDI is assumed to play the crucial role in solving the trade gap than other means of foreign finance. FDI basically bridges the trade gap in two ways:

a. Foreign firms and multinationals bring their own capital and technology and to the extent it reduces the import needs for capital formation, and

b. It goes in to the export sector and raises exportable surplus along with export competitiveness. This helps to increase export earnings and as a consequence stimulates the pace for meeting the gap between desired and actual stock of capital in a greater degree. Further, the pace of social development becomes fast as the government's responsibilities in economic front is borne by the private sector and as such the government has enough time, fund and manpower to implement and monitor social overhead projects.

III) To Fulfill Technological, Managerial and Entrepreneurial Skills

One of the major reasons of underdevelopment of Nepal is that she is lacking modern technology and managerial and entrepreneurial skills. There is always a wide gap between what we have and what we need for our development. The foreign direct investment bridges this gap at least partly, if not wholly. Foreign investment, especially where it is coming through the multinational brings along not only the financial resources and new factories to poor countries but also a package of management experience, managerial ability, technical personnel, entrepreneurial abilities, technological skills and innovative skills in product and technology. Such experience, abilities and skills do not remain confined to the subsidiaries of the multinationals. They spread to other sector also in the process of 'learning by doing' adaptation and imitation. This kind of transfer of technology, skills and knowledge enhances the growth potentials of Nepal and thereby augment the absorptive capacities of the economy to employ all idle resources efficiently and optimally.

IV) To Fulfill the Revenue Expenditure Gap

Ratios of government expenditures and revenue to GDP (GDP at current producer price)

Table: 7

Revenue Expenditure Gap in During 2000/01-2005/06

(In %age)

Fiscal Year	Government Expenditure				Revenue	Gab Between Expenditures and Revenue
	Current Expenditure	Capital Expenditures	Principal Repayment	Total		
2000-01	10.4	6.4	1.3	18.1	11.1	7.0
2001-02	10.6	5.4	1.4	17.4	10.9	6.5
2002-03	10.6	4.5	1.9	17.0	11.4	5.6
2003-04	10.3	4.3	2.0	17.6	11.6	6.0
2004-05	10.5	4.6	2.5	17.4	11.9	5.5
2005-06	10.6	4.6	2.2	17.2	11.2	6.0

Source: Economic survey, 2006/07.

Revenue mobilization is the main source of government expenditures. A minimal gap between the expenditures and revenue is desirable to maintain a fiscal balance. However, revenue growth is not maintaining a pace with the expenditures growth. Ratio of government expenditure to GDP stood at 17.2 % in fiscal year 2004/ 05 compared to 17.4 % in the previous fiscal year. Similarly, in FY 2004/05, the ratio of revenue mobilization to GDP was 11.2 %, a decrease by 0.7 %age-point , compared to 11.9 % in the previous fiscal year. Despite a decrease in both the government expenditure to GDP as well as the ratio of revenue mobilization to GDP, gaps between total government expenditure and revenue mobilization increased by 0.5 %-point to 6 % in FY 2005/06 compared to 5.5 % in the previous fiscal year.

Nepal has been experiencing a wide gap between revenue and expenditure. The gap exists because of low tax yield and high need for expenditure. One of the principal detrimental factors for low tax yield is low level of taxable income. However, other factors such as tax leakages, administrative inefficiency, civic consciousness, lack of transparency, lack of clarity in policies and other loopholes are not less important than taxable income. Therefore, raising taxable income needs the assistance from outside either from foreign government or agencies or individuals as our capacity to spend for development expenditure is low.

Among the three main sources of foreign finance i.e. concessionary commercial loans, unrequited transfers and FDI the FDI is preferred to finance the budget deficit (revenue- expenditure gap) as it serves raising the taxable capacity of the people through producing direct as well as indirect effects and hence tax income of the government. Besides, the higher productivity and profits of multinationals provide a large base for corporate income taxation. Again, through the backward and forward linkage effects, the pace of industrialization is speeded up and the base for corporate income tax is further widened. All these assist to fulfill the resource gap in the economy without imposing any debt burden to the future generation unless otherwise if would have been on them.

VI To Expand Economy through Linkage Effects

FDI stimulates domestic investment and economic activities in the host country through its backward and forward linkages. As regards to the backward linkages, when a multinational sets up a factory in another country, it creates demand for building materials and construction labour. When it starts its production process it creates demand for local raw materials and labour. It means the FDI creates, on the one hand, job opportunities for unemployed labour and, on the other, it creates a large market for the suppliers of raw materials which helps in increasing their production. It creates therefore secondary employment.

6.2 Prospects of FDI in Nepal

6.2.1 Background

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

Nepal is a second richest country in the world in the matter of water resources. Data reveals that theoretical viability of generating hydroelectricity in Nepal is nearly 83000MW and economically or commercially 42000 MW. Nepal possesses wide range of investment prospects which if exploited prudentially would turn out to be highly profitable and beneficial to both investors and general masses including government itself in terms of revenues, prices, terms of trade, balance of payment and employment generation through which the objectives of poverty alleviation and attaining higher rate of growth of the country could be achieved. Nepal must build up her competitive capacities to grab the global market by supplying the goods and services in low prices with standard quality maintenance, which would be made possible only if unexploited sectors are brought optimally into use. For the proper exploitation of these unexploited sectors, Nepal needs more funds and modern machines and machineries and as such must be rendered to foreign investors, firm or corporations to operate singly or in Joint Ventures with domestic firms.

There is no doubt to say Nepal is one of the ideal destinations for foreign investors to invest. But there are still so many obstacles existing in the country like conflict in the different parts of Terai and some areas of eastern Nepal etc. If the government addresses the proper demand of opponents in the right time, it will be further beneficial for attracting larger volume of FDI in the country. Some major prospects of foreign direct investment (FDI) in Nepal are discussed below:

6.2.1 Hydro-Power

Economic indicators reveal that Nepal is one of the underdeveloped countries of the world but in terms of natural resources, Nepal is regarded as a rich country, especially in terms of water resources. It is often argued that water resource is the backbone of Nepalese economy, which could be instrumental to provide a new lease of life to sinking economy. It is believed that nearly 42000 MW. Hydroelectricity can be generated in the commercial level. Nepal possesses more than 6000 rivers, many fountains, lakes, ponds and other sources of water. Most of the rivers flow from northern part of the country to the southern part with very high velocity. Therefore, it is very suitable to generate hydroelectricity in different parts of the country.

At the end of FY 2005/06, a total of 556.4 MW of hydropower (0.67 % of total potentials) was generated from various hydro- power projects. Out of total generated hydropower 550.225 MW is connected in national grid and remaining electricity generated by other medium hydropower centers is providing this service in various local areas. All these data indicates that Nepal has not been able to harnessing water resources properly. The problem of power generation is not limited only to financial resource but equally important inhibiting factors are the lack of skilled human resources, scientific equipments and instruments and lack of advanced technology and technical know- how.

Government has formulated the Hydropower Development Policy 2001 which has provided the basis for the involvement of private sector in the hydro- power projects. This policy has also provided the appropriate incentive to attract foreign direct investment towards the generation of hydro- electricity. Since Nepal is wedged between two populous countries of the world China and India, there are high prospects of exporting hydroelectricity to these countries. Therefore, to intensify the power generation there is high need of collaborating domestic investors with the foreign investors.

6.2.2 Tourism Industry

Tourism is another important sector of the economy and regarded as a source of hard currency. Therefore, economic development of the country also relies on the proper development of tourism industry. Nepal possesses a lot of opportunities for tourism such as;

a. Vast untapped potential in developing both Hindu and Buddhist tourism, heritage tourism, white water tourism, eco- friendly tourism health tourism, mountain tourism, Safari tourism, adventure tourism and ethnic tourism,

b. Image of ever friendly and smiling people,

c. Homeland of brave Gurkha

d. Situated between the word's most populated and emerging economies

e. Quality manpower available in tourism sector,

f. The first nation in South Asia to receive Approved Destination by China

g. NRNs living abroad interested to invest in tourism industry,

h. Promotion of regional tourism,

i. Introduction of new visa fee,

j. Openings of new and previously restricted places in the remote part of the country,

k. Opening of more mountains for expeditions and trekking and

l. Tourism recognized as a sector for alleviating poverty.

The recent political changes has also created good environment for tourism sector. There are still some challenges to address the socio-economic problems existing in the country. In order to promote foreign investment in tourism industry, investment in travel, trekking, rafting and pony trekking business have been opened for foreigners. Despite of all these potentials, Nepal still lacks sufficient tourism spots, luxurious hotels and parks in the tourist area due to the unavailability of funds. To mitigate these physical problems, Nepal must shake or join hands with foreign governments, business firms and individuals in order to fulfill the ultimate goal of the country to make the Switzerland of Asia in one hand and to create sound physical infrastructure and other facilities needed for the tourist on the other.

Present data reveals that 304 tourism industries based on FDI are operat

ing in Nepal till the FY 2063/64 (Department of industry- 2007) with the employment generation of nearly 17203 people. In the context of FDI, tourism sector received the third priority that leveled Rs. 4874.06 million (15.19% of total FDI) .

Hence, there is greater prospects of FDI in the tourism industry. But Nepal is still receiving very low amount of FDI in tourism sector. In order to promote FDI into tourism sector, peace, political stability, good administration, good governance, investor's friendly policy are crucial.

6.2.3 Electrical and Electronic Industries

The electrical and electronics industry sub-sector in Nepal is still in an early stage of development. According to the annual survey of manufacturing establishments 1994/95, there were 37 firms operating in formal sector activities of which 33 were engaged in electrical industries and 4 in electronic industries.

The domestic demand for electrical goods is expected to increase with expansion of the electric power generation system, telecommunication and radio and TV broadcasting. According to preliminary estimates, significant demand exists for heaters, radio, TV and communication equipment and apparatus, electrical appliances and apparatus, batteries, wines, cables, plugs, switches, lighting fixtures and so on. Prospects for setting up industries to produce these items are, therefore, promising.

Nepal offers very good prospects for the development of electronic assembly industries. The low cost of labour would give Nepal a competitive edge over her locations in South and South East Asia. The labour force has the ability to master quickly assembly operations, which involve use of hand tools such as screwdrivers, pliers etc. In addition to the advantage of low cost labour, Nepal provides a conductive environment for dovetail assembly schedule with the production of finished goods in overseas locations on a planned basis. Assembly industries that use airfreight for import of components and export of assembled units should be feasible. The products should have a high value to weight ratio. Kathmandu, the capital, has good air connections to Europe through Frankfurt, London, Paris, Amsterdam, Vienna and Moscow and to the Far East through Singapore, Bangkok, Hong Kong, Sanghai and Osaka.

Some of the electronic industries which could be established in Nepal are computer keyboard assembly, single and double side circuit boards, circuit board stuffing and text service, cable harness assembly, domestic mains multi- socket power strips and similar assembly requiring a high labour content. Therefore, FDI can be attracted in the country for the establishment of electrical and electronic industries.

6.2.4 Mineral Exploration and Exploitation

Nepal is rich in mineral resources. Preliminary geological surveys have revealed that there are varieties of mineral ores, natural gas, coal etc. deposited in various parts of Nepal. However, the extent and possibility of commercial utilization of those mineral deposits are yet to be known.

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

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

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

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

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

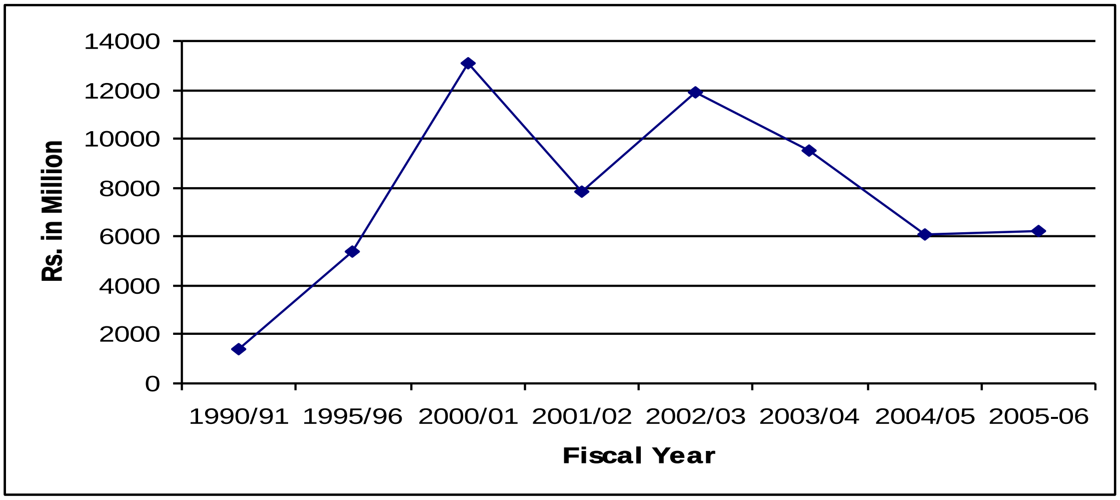
For the exploration and exploitation of all these mineral resources, sufficient capital, efficient manpower, scientific technology, modern equipments are needed. But Nepal is lacking most of these requirements. In this context, foreign direct investment is crucial for the proper exploitation of the mineral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

6.2.5 Readymade Garments

Nepal's export performance over the readymade garment has significantly increased in the post democratic period from a low export value of Rs. 1399.2 million in 1990 to Rs. 13124.7 million in FY 2000/01. But in FY 2001/02 , export of readymade garment decreased to Rs. 7833.0 million . In FY 2005/06 export of readymade garments reached to Rs. 6204.10 million.

Chart: 4

Export of Readymade Garments During (1990/91-2005/06)

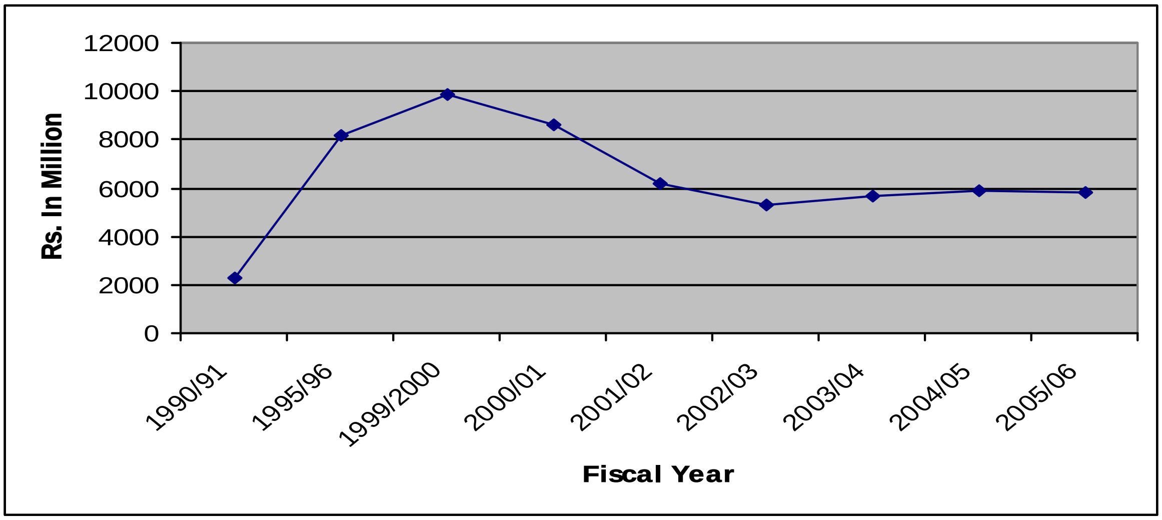


Nepal's export performance over readymade garments presented above shows that export of readymade garment shares larger volume of total export of the country. USA's preferential facility under MFA has contributed for better performance. The potentiality of this industry in the international market is still high due to the abundant availability of low wage rates and low setting up costs. However, the potentiality has not been absorbed in its fullest scale due to the lack of advanced technology, skilled human resources, efficient administrative mechanism and market networks. Foreign collaboration from the investors of foreign industrialized country is necessary to tap the fullest scale for the expansion of this industry

6.2.6 Carpet Industries

Chart: 5

Export of Carpets (Hand Knotted Woolen) During (1990/91-2005/06)



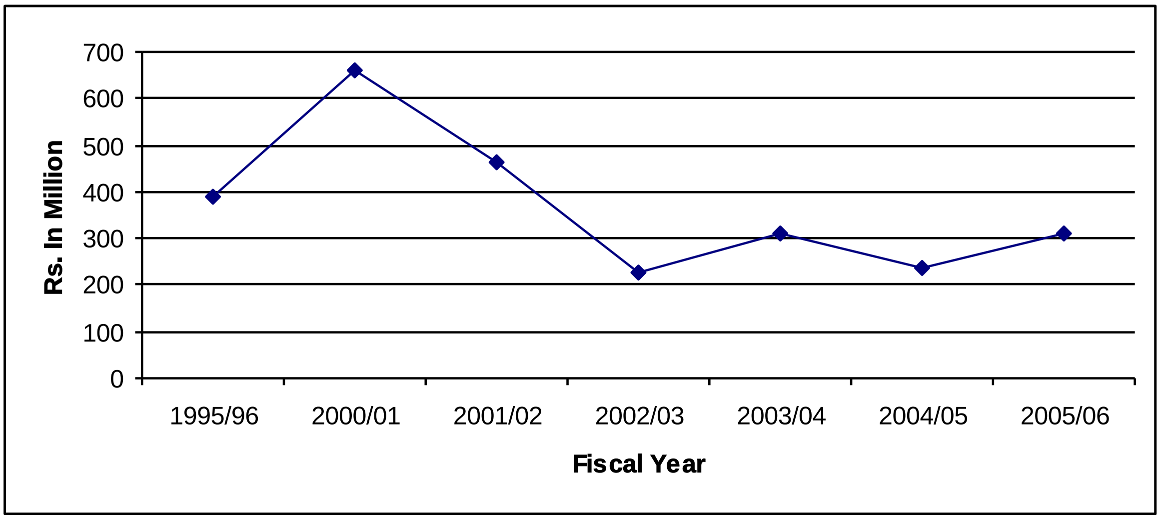
Export of carpets has occupied the second position in Nepal from very beginning. The export of carpet was Rs. 2318.5 million in FY 1990/91 and reached to 9842.1 in FY 1999/2000. In FY 2005/06, the export of carpet reached to Rs. 5838.70 million. The export of this industry is heavily concentrated in the European markets. The potentiality of this industry would further be increased if it is produced in the large scale with the affiliation of foreign firms of having large market networks, advanced technology and efficient management. In the recent time, the mixing of low quality thread and involvement of child labour in the carpet are responsible to degenerate the international credit of this industry. To gain the international credit and produce in low cost, attempts are to be made to avoid child labour and adulteration of lower quality threads by employing advanced tools and techniques and efficient management mechanisms with foreign collaboration, the competitive edge of this industry in international market can easily be gained as we have lower wage rate and low setting cost of plants.

6.2.7 Leather Goods Industries

Leather sector in Nepal is considered as one of the most potential areas in terms of its revenue addition and export possibility. In Nepal, leather sector consists of three main areas; leather processing, leather goods manufacturing and foot wear production. As of now leather sector raw material in different parts of the country gives a greater scope for industrial production of leather and leather goods.

Chart: 6

Exports of Hides and Skins During (1995/96-2005/06)



During FY 1995/96 hides and skins worth Rs. 387.6 million were exported to overseas countries only. But in FY2000/01, the export of hides and skins increased to Rs. 658.4 million and reached Rs. 310.40 million in FY 2005/06.

With regard to leather goods producing industries in the country, about 100 leather based industries are in operation. Of which one fourth are producing leather goods and the rest are on footwear. However, most of the leather based industries are operating on micro-scale using traditional skills and technologies. Taking into consideration the availability of raw materials within the economy there exist greater prospect for the development of leather based industries in Nepal. However it is necessary to improve and diversify the leather goods to be produced in the country. This requires for enhancement of skills and technologies required for quality products as well as dissemination of information of potential export markets.

Based on above stated background information, leather sector could be considered as one of the potential areas with diverse possibilities for enhancing Nepal's industrial sector. This requires for introducing new technologies and information or export market opportunities. Therefore there is greater prospects of attracting FDI in the leather based industries in Nepal.

6.2.8 Air Services

There are 51 domestic airports in Nepal and some of which are all weather and some fair weather airports. The government has embarked on open- sky policy permitting private airlines to operate domestic as well as international air services. 16 international airlines are operating their services in Nepal. Private helicopter services are also coming up in Joint Venture. As Nepal is assumed as one of the ideal destinations for tourism and still most parts of the country are lacking airports facilities, private investment with foreign collaboration would be beneficial for the development of tourism sector also. Therefore, Nepal possesses grater prospects of attracting foreign investment in the further development of air services.

6.2.9 Pharmaceutical Industries

Nepal has a large and growing demand of drugs and pharmaceuticals that are being met by domestic production about 20 % of the requirements and the balance is met by importation. The market for pharmaceuticals is estimated to be more than Rs. 5,000 million. India based national and multinational companies supply much of the demand. The demand for pharmaceutical is expected to increase significantly over the next decades due to improvement of modern health care facilities and establishment of a good transportation network within the country.

Good prospects exist for the establishment of a few industries producing pharmaceuticals and drugs. The best areas for investment are in the production of the major high volume product lines of Essential Drugs out of National list of essential drugs, categorized by Ministry of Health, Department of drug Administration.

6.2.10 Agro and Forest Based Industries

Nepal is rich in bio-diversity. Extraordinary similarities and diversities can be seen here. Nepal comprises diverse topographical structure, multitude soil variety and varied climatic environment because of which various biotic and a biotic factors are capable of being existent here. The existence of these living and non living beings lets Nepal to undertake various kinds of manufacturing, textile, tourism , construction, processing and service industries operation of which supplies basic human needs such as medicine, food, clothes to highly deluxe goods like cosmetics, beverages etc. The major possible investment sub- areas under this heading may be those indicated below.

i. Medicinal and Aromatic Plant

Despite the huge possibility of producing and processing drugs and cosmetics within the national territory, Nepal is forced to import these items. The record explored hither to manifests that we have more than 700 species of medicinal and aromatic plants which were, though collected from time immemorial for various purposes, encouraged to put into commercial use since the establishment of Royal Drugs Research Laboratory in 1962. Till now nearly 300 species have been screened and studied. Recently it has been considered important to commence commercial plantations of medicinal plants such as atropa belladonna and aromatic plants palmarosa , lemon grass, citronella and menthe arveniss. The DOI manual points out the good prospects for the cultivations and processing of chrysanthemum cinerariaefolium (pyrethrum), claviers purpurea (ergot), digitalis lanata, eucalyptus, camaldulenis, glycyrrhizin flabra, mucuna, pruriens, piper longum and valeriana wallichi.

The medicinal and aromatic plants can be exploited for the production of essential oils, medicines, traditional medicines, cosmetics and perfumes, herbal teas, and natural health products. The production of these materials releases the foreign exchange for government to import capital goods and other indispensable materials production of which in the national boundary is naturally denied. Hence, there exists good prospects of FDI for the production of products based on medicinal and Aromatic plant.

ii. Flower Seeds

As Nepal possesses wide variety of agro climate and easily trainable labor force, the investment in this sector with good expertise and technology would render the investor to make good profits by producing various kinds of flowering seeds at lower cost and thereby obtaining good international market. In Nepal as per the record of DOI manual in the summer season the flower seeds grown are zinnia, marigold, gladiolus, salvia, dahlia, canna and in the winter, the flowers like bellies, dianthus, pansy, antirrhinum, helichrysum, aapaver, verbena and so on are grown. The flower seeds identified as highly potential in Nepal are chrysanthemum, morifolium, elshoitzia, californica, and lathyrus odoratus.

Commercial production and export of flower seed require maintenance of high technical standards and good supervision which at present Nepal lacks and as such in needed to attract foreign investors to develop this agro- business in Nepal.

iii. Fruit Processing

Nepal enjoys high opportunities for the cultivations of variety of fruits such as apple, banana , pineapple, mango, orange, grapes, pear, Gurva, peach, citrus, myroblan, pomegranate, plum, apricot and so on processing of which yields good prospects for getting export market. Commercial fruit development programme have been launched to increase the area under cultivation.

In Nepal there have not been any exhaustive efforts towards the development of fruit production and processing. Some small fruit processing industries are engaged in the production of fruit Squash, fruit, juice, jams, jellies, marmalades, and fruit salad. However, we are not able to exploit the opportunities in full scale because of the lack of trained manpower, advance technology and market networks and thus this sector also keeps good prospects for foreign investor to focus their investment on.

iv. Tea Development

In Nepal, tea growing areas are mainly concentrated to the eastern part of Nepal such as Illam, Jhapa, Pachathar, Terhathum and Dhankuta, almost adjacent to the world renowned tea gardens of Darjeeling in India.

The government has accorded high priority to increase tea production in the Eastern Districts with a view to achieving self- sufficiency in tea and to export high quality tea to overseas markets. In order to encourage tea cultivation, an exemption from the land ceiling has been provided together with attractive incentives. Good prospects exist for the production of quality orthodox tea in Nepal similar to the Darjeeling tea produced in India. Improved cultural practices, latest technical know-haw and efficient management systems are required to bring the tea industry in line with other tea producing countries in the region.

v. Processing of Spices

Nepal produces a large variety of spices namely known as ginger, timur, large cardamom, turmeric, medicinal spicy herbs, Himali cummin cinnamon, garlic and variety of chilies. Most of the species cater to domestic demand and some items like Chili, turmeric, garlic, ginger and cardamom are exported to India and other markets in a raw form.

Good prospects exist for the setting up of spice processing industries using automatic, dehydration, cleaning and packing technology to export the products in the international market. Foreign collaboration is required to provide technical know-how for processing and packaging and to secure marketing outlets.

vi. Mushroom Cultivation

Many varieties of mushrooms are found in a wild state in the Terai lowlands, the hills and mountains of Nepal. The temperature and humidity conditions necessary for growing agaricus B. sporus (bottom mushroom) are very satisfactory in the hilly regions during some seasons. Oyster mushroom grow easily during most seasons. Kathmadnu Valley has temperature, humidity and other biological factors suitable for the cultivation of these two varieties of mushrooms throughout the year. The plant pathology section of the Department of Agriculture's Research Station at Khumaltar (Kathmandu Valley) is producing mushroom spawn. The potential for Mushroom production on a commercial scale is good especially with a view to marketing overseas as fresh mushroom, dried mushroom and canned mushroom.

vii. Coffee Processing

Coffee beans are produced in Western Development Region of the country. The planting of coffee has taken impetus since some last years back in other regions of the country as well. However, the tempo of it has not taken place as fast as it should have been because of the lack of institutions and other promotional measures. The felt need is also in the direction of getting market and appropriate price. Establishment of small-scale coffee processing plant would encourage the farmers to grow more coffee beans. This industry can substitute the import and also export high quality chemical free coffee. Investment in this sector from foreign firms, individuals and corporations would prosper the coffee business in Nepal.

viii. Integrated Dairy Industry

Nepal has a long tradition in dairy farming. In fact, Nepal has in the past exported milk products to India and Tibet in the form of ghee and butter. Nepal could develop the dairy industry to meet domestic demand as well as renew exports to India and other markets. Good prospects exist to produce Yak Cheese in high altitude for export to overseas markets. The topographical and climatic conditions are suited to dairy development. Integrated dairy industry incorporating related activities such as improved livestock, cattle feed production and processing of milk products would offer promising prospects for profitable investment. Such a project could be built up on existing small dairy units spread around the country through and well organized programme of extension services to improve livestock breeds and an efficient collection system for processing in a central unit.

CHAPTER VII

SUMMARY, CONCLUSION AND RECOMMENDATIONS

This chapter presents the summary, conclusion and recommendations. The whole chapter is divided into three sections. The first section deals with summary while the second section deals with key finding and the third section deals with recommendations.

7.1 Summary

They key goal of developing countries like Nepal is to attain high economic growth rate and reduce poverty with macroeconomic stability. The Three-year Interim plan (2007-10) aims at attaining GDP growth rate of 5.5% and reducing overall poverty ratio form 31% to 24%. In order to achieve these targets, foreign direct investment (FDI) is viewed as an engine for economic development of Nepal as it provides required capital and technology and generate employment opportunities and thus, idle resources get utilized which, in turn, helps to expand production capacities of the country and also opens the access of products to world markets. Thus, foreign direct investment plays the vital role to pave the way for economic development for underdeveloped countries like Nepal.

Given the importance of foreign direct investment, this study has specific objective of analyzing the nature and trend of foreign direct investment and its prospects in Nepal. The present study sets the following objectives;

i) to analyze the past trend of FDI in Nepal,

ii) To examine policies and incentives relating to foreign investment in Nepal,

iii) To examine the prospects of FDI in Nepal,

iv) To examine the needs of FDI in Nepal,

v) To suggest recommendations.

This study is based on secondary data. For the purpose of the study, the necessary data on macro-variables were collected for the period of FY 1989/90 to FY 2006/07. No test has been done for checking reliability of these data.

In order to analyze the trends of foreign direct investment in Nepal different tools like graph, table, figure etc. are used. The trend and structure of foreign direct investment has been analyzed by sector, year and country for the period from FY 1989/90 to FY 2006/07.

The amount of FDI was Rs. 466.84 million in FY 1989/90 which increased to Rs. 2453.12 million in FY 2006/07. According to DOI records, the highest foreign investment flow after 1990 was Rs. 3102.56 million in FY 2000/01. Till now, Nepal has been able to attract FDI of only Rs. 32075.19 million which is very low in comparison to other countries. Available data for FDI reflects that 1218 foreign investment projects were approved in Nepal comprising of all categories of industries, worth a total of 96.74 billion. The total fixed capital is estimated at Rs. 80.10 billion as of July 2007. FDI provided employment to 112889 people. The Joint Ventures of India, China, U.S., Japan, Germany and South Korea are prominent in the structure of FDI. Indian Joint Ventures accounted for 43.73% of total FDI.

Categorically, there are only seven industries based on FDI in Nepal which include Agriculture, Manufacturing, Tourism, Construction, Energy-based and service. The inflow of FDI was found highest in manufacturing sector that marked Rs. 13815.35 million (43.07%) while FDI inflow was found lowest in mineral-based enterprises that marked Rs 55.98 million as of July 2007.

By type the flow of foreign direct investment consists of equity, equity plus technology transfer and technology transfer only. According to DOI, the inflow of FDI in Nepal has mostly been in the form of equity investment that runs 1111 industries following by technology transfer (56) and e equity investment and technology transfer (51).

By scale flow of FDI reflects that most of FDI has mostly been concentrated in small scale industries in which there are 906 total industries followed by medium scale industries (184) and large scale industries (12.8).

Nepal has formulated laws and policies governing FDI. Many facilities and incentives have been offered in order to maximize the locational advantage of foreign investing firms. In this regard, the Foreign Investment and Technology Act 1981 was enacted. The salient futures of the Act were, a) Industrial units set up under the Act would not be nationalized; and b) Industrial units set up under the act would receive the same facility, concession and protection as provided by the Industrial Enterprise Act, 1982. Similarly, Foreign Investment and Technology Transfer Act, 1992 was came into existence to attract technology transfer and foreign investment. According to the Act, foreign investment implies the investment made by a foreign investor in any industry as investment in share (equity), reinvestment of the earnings derived from the investment in share (equity) and investment made in the form of loan or loan facilities.

The tenth plan (2002-07) accorded priority to foreign investment. According to it, measure would be undertaken to attract more FDI in the areas of comparative advantage to enhance competitiveness. Similarly, the recent Three Years Interim Plan also aims to raise the inflow of FDI. For this, this plan has adopted some policies like; i) FDI will be encouraged in venture capital ii) proper policies will be adopted to attract capital, skills, efficiency and technology of NRNs iii) High Level Board of Investment will be activated to facilitate FDI, and so on.

For underdeveloped countries like Nepal, FDI is indispensable in order to mobilize the idle resources. Nepal is facing the problems of revenue-expenditure gap, trade gap and investment - saving gap. In order to mitigate such problems, FDI is needed for this country. Similarly, FDI is needed to fulfill technological, managerial and entrepreneurial skills, and to expand economy through linkage effects.

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

7.2 Key Findings

The major conclusions derived from this study are as follows:

1. Economic indicators reveal that Nepal's performance is very vulnerable in terms of GNI per capita, commercial viability of natural resources, the extent of poverty and human development prospects. Nepal has not been able to harness its existing resources. In this regard, FDI is a crucial factor which helps to mitigate all these problems to some extent.
2. Despite various policy and legal reforms that have been undertaken and incentive provided in the field of FDI and associated sectors for reaping the maximum benefits of FDI, the country has been able to attract only limited inflows of FDI with the concentration mostly in Central Development Region in SMEs, and mainly from India, USA China, Norway and Japan.
3. According to present study the constraining factors for foreign investment in Nepal are inadequate infrastructural base, poor state of law and order, lack of skilled and trained manpower, lack of facilitation and effectiveness of one window system, landlockedness position of the country, existing conflict in different parts of country, especially in the Terai region (at present), small market size, bureaucratic hassles, frequent stalemate between India and Nepal over trifle transit and other trade issues and inadequacies and inconsistencies in policies.
4. According to the Population Census 2001, the economically active population was estimated to be 10.482 million and total population was estimated to be 23.15 million. Data reveals that total population

employed in different industries based on FDI are estimated to be 112889. Therefore FDI has contributed employment to only 1.07 % of total labor force and 0.49 % of total population.

Manufacturing sector alone has generated 66067 employment opportunities that are estimated 0.63 % of total labor force and 0.28 % of total population. Similarly total labor force employed in different industries of Nepal are estimated to be 346077 (Industries statistics DOI 2006/07), of which FDI has contributed employment as 32.61 % of total industrial labor force and manufacturing sector alone has contributed 19.09 % of total industrial labor force. With respect to these data, we may conclude that category-wise possesses very limited employment opportunities but is dominated by manufacturing sector, which is an example of unequal FDI distribution in Nepal. Therefore, FDI has become critical.

5. A total of 52 countries have invested in Nepal, in which India, China, U.S.A. Norway, and Japan were major FDI sources. India alone has invested 43.72% of total FDI and 29.47 % projects in all sectors. This shows that FDI is mainly concentrated from India compared to other countries.

6. By scale, FDI has mostly been concentrated is small scale industries in which there are 906 total industries which is equivalently equal to 74.38% of total FDI projects, while medium and large scale industries occupy second and third position, respectively. This trend also indicates that FDI is basically directed towards small scale industries.

7. By development region. Out of total 1218 FDI projects, Central Development Region alone has received 1000 FDI projects which occupies 82.10 % of total FDI projects and remaining other Development Regions occupy only 17.90 % of total FDI projects.

Therefore, FDI has mostly been concentrated to Central Development Region and it is another example of unequal FDI distribution in Nepal.

8. The prospective investment areas in Nepal include agriculture and agriculture related production, manufacturing industries, such as readymade garment and carpet, hydropower, tourism and service industries.

9. Despite various constraints faced by foreign investors, Nepal possesses a lot of prospects to attract foreign investors because of small bureaucracy, friendly socio-cultural environment and high incentives and facilities available in the country. The availability of cheap labor force, growing markets and other raw materials also attract them to invest in the country.

10. Even if both saving and investment are growing; the growth rate of saving is lower than growth rate of investment, which causes the widening saving-investment gap in Nepal. Due to high investment-saving gap, the inflow of FDI has become essential in order to maintain the targeted growth rate. The FDI has contributed to bridge the saving-investment gap to some extent.

7.3 Recommendations

The following are the major recommendations suggested based on the findings of the study:

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

2. Maximum publicity: As Nepal is ideal destination for foreign investors owing to its rich natural endowments, abundant and cheap labor force and huge markets in neighboring countries, publicity of Nepal as an investment center through foreign diplomatic offices and commercial diplomatic offices is necessary.

3. Develop Infrastructure: Nepal is still lacking the basic infrastructures due to which the flow of foreign investment and other development activities are less than impressive. The most serious problem in this regard is the skewed distribution of roads, the communication network highly concentrated in a few towns and cities and the meager supply of power for industrial use. So, it is necessary to expand infrastructural base in the economy with the concentrated effort in those regions where these facilities are not adequate.

4. Build up National Consensus: National consensus is the foremost requirement of the overall development of the country. It is particularly required for restoring peace in the country, for the stability of any policies formulated and effective implementation of the planned programme. Any matters concerning people and the country must be decided unanimously so that the domestic institutions, foreign individuals, foreign government and other institutions have confidence over that matter in the sense of its continuity for a long time, irrespective of the change in government. In reality, the fear in the mind of domestic as well as foreign investors hovers in that the policies once formulated by one government will discontinue in case the government changes. This is a consequence of absence in national consensus, particularly absence in political

consensus. So it is recommended to maintain national consensus over the issues affecting people and the development of country.

5. Making Active Nepali Diaspora: Necessary measure should be taken to make active the Nepal Diaspora (i.e. Investment Forum of NRN). The government should grant the visa of ten years for NRNs to encourage them in the investment activities. Similarly, there should be the provision of dual citizenship for NRNs. Therefore, government should create favorable environment to encourage NRNs in investment activities.

6. Visas and Repatriation Procedures: There is need for a) Speedy granting of Visa to the foreign investors or authorized representatives of foreign companies on the recommendations of FNCCI on preferential basis, b) Granting of multiple entry visa for the businessmen and their spouses and dependents, and c) an increase in the period of residence visa.

7. One Window System: One window System has to be made effective through the introduction of one stop service center. The center should be made autonomous and operated by the private sector while empowering the scope of addressing investors complaints, for which the development of competent private sector is necessary.

8. Tax Reforms: Tax reforms have to be made by introducing transferable vouchers for tax and duty refunds, setting administrative units for large taxpayers, removing advance tax payment scheme, and stopping frequent change in tax structure for foreign investors. An efficiently administered, internationally competitive tax and regulation regime is equally essential.

9. Making Strong Networking: It is necessary to make strong networking among the Nepalese investors with foreign investors through FNCCI, NCI and other umbrella organizations.

10. Establish R and D Institutions: Nepal is lacking adequate research and development institutions. The establishment of R and D institutions is a must if Nepal's all round development is to be achieved in a faster pace. If we explore the potential areas of investment, natural resources hitherto unexplored and other natural resources, the domestic or foreign investors may get impetus for active involvements in the economic activities, particularly for the expansion of trade with other countries and thereby achieving targeted rate of growth, high living standard of people and alleviating poverty.

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

12. Create Foreign Investment-Friendly Environment: One major challenge is the situation where foreign investment-friendly

environment has not been created. The development of entrepreneurship, use of advanced technology, and promotion of technical capacity have to be encouraged in order to reap benefits and face challenges emerging after the WTO membership and the SAPTA, SFATA and BIMSTEC agreements. Similarly, we have to create friendly environment for foreign and domestic investment for the exploration, development, and commercial operation of national mineral endowments.

13. Conduct Workshop and Seminar: It is necessary to launch a workshop and seminar among foreign and domestic investors in order to familiarize the potentiality and profitability of Nepalese economy to foreign investors. Such programmes should be launched domestically and internationally as per the requirement. It is also necessary to inform foreign investors about the laws and acts governing FDI and the facilities and incentives along with the procedures falling there under.

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Appendix- I

Number of Industries Approved for Foreign Investment by Fiscal Year (UP to FY 2006/07 FNM)

(Rs. mln.)

Fiscal Year	No. of Industries	Total Project Cost	Total Fixed Cost	Foreign Investment	Total No. of Employment
Up to July 1989	59	5425.92	4581.82	466.84	10586
1989/90	30	2438.19	2139.60	398.51	9515
1990/91	23	863.56	690.74	406.28	2974
1991/92	38	3508.17	2902.10	597.84	5615
1992/93	64	17886.22	16210.81	3083.67	13873
1993/94	38	3733.23	3175.66	1378.76	4734
1994/95	19	1627.28	1247.85	477.59	2386
1995/96	47	10047.47	9398.54	2219.86	8032
1996/97	77	8559.25	6692.15	2395.54	9347
1997/98	77	5569.38	5142.32	2000.28	4336
1998/99	50	5324.42	4380.17	166.42	2146
1999/00	71	2669.09	1910.24	1417.61	4703
2000/01	96	7917.62	6122.49	3102.56	6880
2001/02	77	3318.53	1559.59	1209.65	3731
2002/03	74	4921.82	3608.25	1793.77	3572
2003/04	78	4323.74	3775.86	2764.80	2144
2004/05	64	1801.10	1150.89	1639.52	5576
2005/06	116	4121.08	3296.95	2606.31	7358
2005/06 FNM	85	2895.70	2191.46	1558.34	4802
2006/07 FNM	121	2690.21	2123.54	2453.12	5398
Total	1218	96741.27	80108.15	32075.19	112889

Source: Department of industry, Government of Nepal, FY 2006/07

Appendix – II

Number of Industries Approved for Foreign Investment by Country of Origin (Up. to F.Y. 2006/07 FNM)

(Rs. mln.)

S.N.	Country of Origin	No. of Industries	Total Project Cost	Total Fixed Cost	Foreign Investment	Total No. of Employment
1	Australia	12	276.79	236.18	225.70	414
2	Austria	10	180.06	138.91	57.86	409
3	Azerbaijan	1	7.40	6.70	7.40	27
4	Bangladesh	13	448.64	209.04	213.70	3766
5	Belgium	6	21.77	18.00	16.74	160
6	Bermuda	6	1995.25	1694.03	118.27	1474
7	Bhutan	3	27.26	20.58	3.61	98
8	Brazil	2	21.07	7.50	4.43	221
9	Bri. Virg. Is	3	2739.79	2636.19	961.43	1018
10	Canada	13	823.69	698.82	667.01	1504
11	China	151	9882.19	8106.92	3299.95	10185
12	Denmark	5	531.02	470.88	34.69	398
13	Finland	4	22.50	17.76	12.05	134
14	France	29	472.09	394.65	196.19	1476
15	Germany	50	1967.32	1783.77	648.72	2939
16	Ghana	1	6.50	6.18	1.95	0
17	Guatemala	1	10.00	5.00	2.50	84
18	Hong Kong	15	1343.54	1099.44	525.24	2075
19	India	359	36616.80	28335.21	14025.91	45700
20	Iran	4	14.20	8.30	10.20	69
21	Ireland	3	709.40	669.40	326.97	244
22	Israel	5	616.60	510.09	78.00	129
23	Italy	14	1232.95	1115.46	184.77	391
24	Japan	125	3016.04	2587.56	1041.08	5950
25	Libiya	1	5.00	2.80	5.00	80
26	Malaysia	7	524.64	491.47	82.08	252
27	Mexico	1	7.93	6.85	5.33	20

28	N. Korea	1	44.82	41.20	12.55	71
29	Netherlands	23	1108.54	921.81	447.95	90
30	New Zealand	7	283.63	228.66	17.07	1994
31	Norway	7	8035.59	6692.40	1061.33	538
32	Pakistan	12	315.75.	228.71	137.33	2365
33	Panama	1	83.28	65.17	24.98	121
34	Philippines	6	940.68	862.16	54.85	1428
34	Poland	3	92.22	87.55	9.89	77
36	Portugal	1	2.50	2.00	2.50	23
37	Russia	7	161.55	115.23	59.52	414
38	S. Africa	3	32.50	26.84	32.50	84
39	S. Korea	71	1872.50	1552.09	1026.33	3709
40	Singapore	12	1618.02	1560.19	346.49	1196
41	Solvenia	1	4.19	3.94	4.19	0
42	Spain	5	67.22	44.26	37.23	158
43	Sri Lanka	3	79.15	55.90	37.41	83
44	Sweden	2	3.20	2.41	3.20	18
45	Switzerland	23	542.48	486.25	147.45	392
46	Taiwan	8	412.75	358.83	172.62	571
47	Thailand	8	953.12	813.38	91.64	1106
48	Turkey	3	13.70	8.32	26.20	54
49	UAE	2	278.54	87.24	80.00	398
50	UK	54	2697.78	2274.07	881.88	6147
51	Ukraine	2	91.70	83.25	16.40	52
52	USA	114	13478.41	12227.64	4584.90	10415
Total		1218	96741.27	80108.15	32075.19	112889

Source: same as appendix I

Appendix – III

Number of Industries Approved for Foreign Investment by Category and Scale (Up to FY 2006/07 FNM)

(Rs. mln.)

Category	**Scale**	**No. of Indus.**	**Total project cost**	**Total Fixed Cost**	**Foreign investment**	**Total No. of Employment**
Agriculture	Medium	5	270.42	240.93	40.86	623
	Small	10	169.74	144.27	60.90	400
	Total	15	440.15	385.20	101.76	1023
Construction	Large	3	417.04	383.83	238.58	264
	Medium	7	386.37	291.14	183.90	338
	Small	13	383.53	234.79	268.53	942
	Total	23	1186.93	909.77	691.01	1544
Energy Based	Large	13	19421.47	17860.89	3337.21	4436
	Medium	4	349.39	263.94	85.00	393
	Small	2	43.44	24.94	10.25	70
	Total	19	19814.30	18149.77	3432.45	4899
Manufacturing	Large	60	23921.81	19103.21	7845.48	13673
	Medium	109	8806.53	5748.01	2897.54	18517
	Small	353	6785.28	3737.34	3072.32	33877
	Total	522	39513.62	28588.56	13815.35	66067
Mineral	Large	2	1149.92	1065.32	45.98	1111
	Small	2	13.22	8.00	10.00	146
	Total	4	1163.14	1073.32	55.98	1257
Service	Large	20	13973.22	12369.01	6750.04	8253
	Medium	36	2027.87	1686.95	975.18	2265
	Small	275	2322.15	1508.77	1379.36	10378
	Total	331	18323.23	15564.73	9104.58	20896
Tourism	Large	30	12712.10	12344.45	2673.73	7298
	Medium	251	1295.33	1222.03	715.02	2343
	Small	304	2292.47	1870.33	1485.31	7562
	Total	304	16299.90	15436.81	4874.06	17203
Grand Total		1218	96741.27	80108.15	32075.19	112889

Source: Same as appendix I

Small scale industries are only foreign Investment

Appendix –IV

Number of industries approved for Foreign Investment by sector (FY 2006/07 FNM)

(Rs. in mln.)

Sector	No. of Indus.	Total Project Cost	Total Fixed Cost	Foreign Investment	Total No. of Employment
Manufacturing	29	1327.09	938.77	1281.03	1931
Agriculture and forestry	*7*	*101.82*	*59.42*	*91.53*	*268*
Food, beverage and tobacco	*1*	*700.00*	*530.00*	*700.00*	*175*
Textile and Rea. Garment	*9*	*44.70*	*25.97*	*43.20*	*549*
Paper and P. Product	*6*	*144.96*	*99.34*	*121.67*	*189*
Non-Met Mi. Product	*4*	*286.91*	*193.64*	*221.91*	*494*
Febric metal, M/C and	*2*	*48.70*	*30.40*	*48.70*	*238*
Electricity, water, Gas	1	111.00	107.30	30.30	0
Mineral	1	10.00	5.00	10.00	128
Construction	2	41.37	31.13	37.09	95
Hotel and Resort	22	133.02	95.89	90.50	618
Trekking business	10	65.72	57.32	60.29	290
Service Industries	56	1002.00	888.13	943.91	2330
Total	121	2690.21	2423.54	2453.12	5398

Source: Same as appendix I.