A STUDY ON FOREIGN DIRECT INVESTMENT IN NEPAL

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CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

Foreign direct investment takes a significant role in the development of modern economic relations. It's more important today, especially for developing countries. With its enormous potential to create jobs, raise productivity; enhance exports and transfer technology, foreign capital is a vital factor in the long-term economic development of the world's developing and developed countries. The substantial flow of FDI to a least developed country like Nepal is instrumental in developing and expanding its industrial base, promoting industries of national priority and having comparative advantage, improving competitiveness of the existing industries thereby increasing industrial productivity and ultimately contribution to creating a broad based and high economic growth rate (Dahal, 2007:15-17).

Nepalese economy is passing through the critical phase of low-level equilibrium trap circumscribed by poverty and stagnation. The present level of capital formation of Nepal is too low and any substantial increase in saving is not possible due to extreme low level of income and wide spread of poverty. At this juncture, one of the alternatives to pull the economy out of the vicious circle of poverty is the foreign capital. In fact, it is supplement to fulfill the deficiency of the domestic capital. Hence, most of the developing countries irrespective of their size and political systems are now trying to attract foreign investment. A large number of developing countries have now established Export Processing Zones (EPZ) to attract foreign investment (Dahal, 2007:17).

Foreign investment and technology transfer in most of the countries started in a massive scale after the 1980s since grants, loans and aids that used to flow to these countries were cut down heavily by the developed countries. Along with that FDI is also considered important since it imports with it managerial skills, technologies, employment opportunities, training opportunities, etc. It is also a very useful tool in mobilizing internal domestic saving (Gyawali, 2007:7).

Theories of FDI suggest that national and foreign private sector enterprises, if permitted to operate in a competitive market condition, offer developing countries the best prospects for faster national economic growth. This would provide opportunity to add new resources - capital, technology, management and marketing- to the host economy ensuring efficiency and stimulates change. Foreign Direct Investment offers advantages in terms of export market access arising from economies of scale in marketing of foreign firms or from their ability to gain market access abroad and also helps in bridging host country's foreign exchange gap (Koirala, 2006:14).

Nepal started its effort to attract Foreign Direct Investment (FDI) since the sixth five year plan (1980-1985) but an FDI promotion strategy was only adopted in 1992. After the restoration of multiparty democratic system in the country in 1992, the elected government adopted the new policy measures in several economic spheres including new industrial policy for speeding up the process of industrialization through mobilizing the local capital as well as attracting foreign investment and technology in the country. The Foreign Investment and Technology Transfer Act 1981 as amended in 1992 lays down the law governing foreign investment and the applicable rules and regulations. The Industrial Policy 1992 identifies foreign investment promotion as an important strategy in achieving the objectives of increasing industrial production to meet the basic needs of the people, and to pave the way for the improvement in the balance of payments. The Industrial Policy of 1992, Industrial Enterprise Act 1992, Foreign Investment and Technology Transfer Act 1992 have made many provisions to the foreign investors with facilities and concessions especially of tax facilities, licensing and also for the settlement of disputes regarding VISA facilities. A 1996 amendment eliminates the fixed assets limit and expanded the scope of foreign investment in all industries except those few in the negative list.

However, the ninth five year plan (1997-2002) has also set the objectives to ensure the safe entry of foreign capital, technology and managerial and technical skills particularly for the development of industry, tourism, water resources and infrastructure; to accelerate the process of industrialization through mobilization of foreign investment and private sector participation. The tenth five year plan (2002-2007) also aims to meet increasing investment requirements and invite modern technology and management (National Planning Commission, 2002:57).

Foreign investment is welcome in Nepal in all types of industries except the defense related industries, cottage industries, small scale and medium scale industries having less than NRs.30 million in the fixed assets as well as cigarette, bidi (tobacco), alcohol excluding 100% export oriented industries. Foreign investors are permitted to have a joint venture unit with Nepalese partner or 100% foreign owned unit. However, the Industrial Promotion Board in Nepal will not license foreign investment that is judged to be either hazardous to general health or environment.

Comparing with two decades back foreign investment is growing in Nepal but it doesn't mean all are running smoothly. Complains are often heard from the foreign investors about the problems they face before and after investing in Nepal. Foreign investment in Nepal is a subject which has received less attention in terms of data collection and analysis than any other aspects of economic development. Hence, proposed study is, therefore, an effort to analyze the impact of government laws and policies on foreign investment, trend and structure of foreign investment in Nepal, and to suggest the way of promoting foreign investment in Nepal.

1.1.1 Role of Foreign Investment

Most developing countries lack resources required to meet the financial requirements of economic development. They require foreign capital and technology for socio-economic development. Previously, much of the resource gap was managed through foreign loans and grants, but due to the world wide economic and financial crisis of 1980s, many donor countries curtailed their Official Development Assistance and therefore, foreign private capital remained the only alternative source available to many developing countries. Thus, foreign investment can assist industrial growth and hence, economic development in several ways, like:

3. It supplements domestic private capital.

4. It demonstrates the way in which industrial expansion and development could take place.
5. It brings in technical know-how and managerial expertise.
6. It can develop the organized capital market in the country.
7. It promotes employment opportunities and also helps national savings.
8. It, in the form of collaboration imparts training and development to entrepreneurs and promoters.

The basic objective of promoting foreign investment and technology transfer is to make the economy more viable, dynamic and competitive through maximum capital, human and other resources. It is clearly stated in the preamble of FITTA (1992) that whereas, in the process of industrialization of the country, it is expedient to promote foreign investment and technology transfer for making the economy viable, dynamic and competitive through maximum mobilization of limited capital, human and other natural resources.

1.1.2 Objectives of Foreign Investment in Nepal

The Foreign Investment and One Window Policy (1992) has specified four policy objectives for increasing FDI in the country:

a. To strengthen and give dynamism to the economy by extending productive activities thereby creating possibilities for further income and employment opportunities.

b. To increase the involvement of private sector participation in the industrialization process.

c. To increase productivity by promoting foreign capital, modern technology, management and technical skills and mobilizing internal resources in the productive sector, and

d. To enhance the competitive strength of the country in the international market.

1.2 Statement of the Problems

Nepalese economy suffers from serious structural constraints accompanied by unprecedented political turmoil for the last ten years. Economy is strangulated by landlocked position, rugged topography with limited cropland, poor resource base, a high extent of poverty, and rampant corruption. However, Nepal has enormous economic potential comprising water resources, tourism, human resources and biodiversity, which require huge spending through bilateral and multilateral assistance and private sector participation to exploit potential ensuring targeted growth of 6.2 percent during the Tenth five year plan. In a poverty-stricken economy like Nepal where internal resources are extremely limited, not enough to supplement current expenditures and dependence on 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 Foreign Direct Investment (FDI) is crucial not only to sustain development activities but also for poverty alleviation. Thus, no one can deny the role of foreign investment in economic growth and development of the country.

An assessment of the FDI policies in the pre-democratic and post-democratic period in Nepal is thus recognized as the problem of the present study.

1.3 Objectives of the Study

The basic purposes of the study are to analyze the situations of FDI condition and analysis past, present and future condition of FDI in Nepal. It also aims to identify leading factors causing in FDI and aims to suggest mechanism to combat with FDI Problems. The major objectives of this study are-

2. To examine the overall structure of foreign direct investment in Nepal.
3. To analyze the trend of foreign direct investment in Nepal.
4. To analyze the existing laws and policies relating to foreign direct investment in Nepal.
5. To suggest the way of promoting foreign investment in Nepal.

1.4 Significance of the Study

The significance of foreign investment can be justified from the following standpoints:

a. Foreign investment is an important channel for transferring technology and managerial skill.

b. Project of foreign investment provides greater access to world markets for the host country exports. These projects also facilitate market penetration and market expansion.

c. Foreign investment as a package of resources that complements other financial flows to developing countries like Nepal & make a distinctive contribution in developing process.

d. This study provides a summary of pattern, policies & prospects concerning foreign investment in Nepal. Emphasis of the study is on the factors that affect the patterns and trend of foreign investment in Nepal.

e. In study outcome of such detailed study has policy implication for future efforts to promote foreign investment and the future planning and management of foreign investment & technology transfer activities in the country. The study is therefore, expected to be of interest to the policy makers, planners, financiers and others interest in foreign investment & technology transfer in Nepal.

1.5 Limitations of the Study

A comprehensive study, regarding the implications of foreign investment in the Nepalese economy requires a highly sophisticated research study that reaches every dimension of the problem. However, confined to various limitations, a highly sophisticated research capable of evaluating every pros and cons of foreign investment is not possible here.

Due to the limited time frame and resource constraints, this study is mainly concerned with the laws and policies of foreign investment in the pre-democratic and post-democratic period and trend and structure of foreign investment in Nepal. The data necessary for the study are collected mainly of above mentioned period.

1.6 Organization of the Study

The present study is organized in five chapters. They are as follows:

Chapter -one introduces the background of the thesis, which includes; statement of the problem, justification of the study, objectives of the study, limitations and organization of the study.

Chapter -two introduces literature review, which includes; review of related studies. Chapter -three introduces research methodology, which includes research design, source of data, statistical tools used, data processing and analysis and definition of some of the major terms used in the study.

Chapter four incorporates with the analytical part of the study. This chapter is divided into two parts. First part analyses the government laws and policies regarding FDI and second part analyses the trend of foreign direct investment in Nepal.

The last chapter -five presents the summary, conclusion and recommendation for further study.

CHAPTER TWO

LITERATURE REVIEW

2.1 Theoretical Review

The theory of foreign direct investment has mentioned that perhaps the most sensitive area in international economics today is direct investment. According to Charles, P. Kindleberger, major difference between portfolio and direct investment is that direct investment involves control, whereas portfolio investments do not. Control is a legal concept and rests on hundred, ninety eight, fifty one or forty eight percent ownership of the equity of a foreign corporation. Or control is thought of in decision-theory terms, which meant that the head office makes decisions respecting foreign operations, within a clearly laid-out scheme, on such questions as choice of top personnel, new products, capital budgeting, research and development, and dividend policy. But direct investment is a capital movement combined with control and perhaps other elements, such as technology (Kindleberger, 1973:45).

It is observed however that direct investment often does not involve a capital movement. A firm will undertake investment abroad with funds borrowed in the local country. It may provide the equity in foreign exchange, but if it is going into a joint venture, this equity investment may take the form of patents, machinery, technology, or other real considerations. Once the investment become profitable, it grows from local borrowing and reinvested profits.

Other theories are not lacking. In one view direct investment is akin to gambling. A firm undertakes a small investment abroad and tries to pyramid it into a large stake, much as a gambler leaves his winning on the table. It is noticed that 50 percent of the profits on direct investment is reinvested on balance, so the rule of thumb develops that direct investment withdraw half its earnings and pyramid the other half. Or the direct investment is the last stage in a technological cycle. First comes domestic production, then exports, and when imitation abroad is about to take over, the company undertakes production abroad (Kindleberger, 1973:49).

Moran and Contributors have mainly identified two approaches to the theories of foreign direct investment. The first they call ‘the pro-foreign approach’ which is based on the belief that national and private foreign sector enterprises if permitted to operate in a competitive market condition offer developing countries the best prospects for speedy national economic growth. The analysts of this approach picture foreign investors as adding new resources- capital, technology, management and marketing- to the host economy in a way that improves efficiency and stimulates change. As against this approach, the ‘dependencia approach’ emphasizes the risks that multinationals pose for the third world. The analysts of this approach assert that Multi National Enterprises (MNEs) soak up local capital for their projects rather than bring in many new resources; employ technologies suitable not for host countries but for their own; and that they rather drive domestic producers out of markets than strengthening them by inculcating entrepreneurial talent and competitive capacities.

Jenkins has classified the approaches to foreign investment in a different way. He categorizes the approach into two heads: Pro-TNC (Trans National Corporation) and TNC critics, under which he has further added two subdivisions, namely, neo-classical and neo-fundamentalist in the former category and global reach and neo-imperialist in the later.

The neo-classical writers base their arguments on neo-classical economic theory which stresses the optimum allocation of resources through the greater involvement of private sectors for the betterment of the larger number of the people and the nation as well provided that the state plays its role with minimum intervention required for maintaining law and order and formulating acts and policies consistent to creating contestability in the market. According to them, TNCs act as efficient allocators of resources internationally so as to maximize world welfare. Similarly benefits are assumed to accrue to both home and host countries.

Neo-fundamentalists have found foreign investment in the developing countries overwhelmingly prolific and economically beneficial and hence argue that it must not be taken as a cause of dependence but rather as a means of reinforcement and diversification of the host countries.

Authors who emphasize the oligopolistic nature of the TNCs give the contrasting view of the impact of TNCs. According to the ‘global reach approach’ foreign investment is to be seen as part of the strategy of oligopolistic firms and not simply as a resource flow. It also views the need for state control on TNCs, particularly the regulation of transfer pricing and restrictive business practices. In contrast with neoclassical, these authors also believe in ‘unpacking’ the foreign investment.

2.1.1 Changing Perception & Role of FDI

There has been a dramatic shift in the attitude of developing countries towards foreign direct investment (FDI) in recent year. The change has become particularly visible since mid-1980s. By now, most developing countries have adopted a much more favorable view of FDI. A number of factors lie behind this new orientation. The “debt crisis” of the early 1980s caused a spectrum of falling investments, reduced or even negative growth, mounting fiscal deficits and deteriorating balance of payment in many developing countries. As they turned to international institutions both for financial assistance and policy advice, they were increasingly required to open up their markets to FDI which was seen as a means to compensate for reduced access to bank credits. The need for reliance on FDI was also reinforced by the declining trend in official development assistance. Meanwhile, the changing nature of activities of transnational corporation (TNC) led to more benign perception of their role. Many TNC moved into manufacturing activities in developing countries with greater possibilities for forward & backward linkages. Many of them become engaged in export printed manufactures, complementing the national development objectives of achieving improved balance of payments and greater industrialization simultaneously. In the context of export promotion, the role of TNCs is assuming greater significance in view of the increasing importance of intra firm trade in global trade (UNCTAD, 2003:17).

Transitional corporations were being increasingly looked upon as sources not of capital, but also of promotion, management & marketing technologies. (World Development Report: 1986) Thus many developing countries started liberalizing their FDI policy regimes on the basis of the new perception of community of interest. The trend towards liberalization effect; as some countries liberalized, others followed suit.

The above factors have been complemented by other supportive changes in the global economic sense. These changes involving greater “componentization” of production, convergence of demand patterns and reduced cost of cross-border transport & communication have created favorable condition for a greater number of developing countries to attract FDI.

In an underdeveloped country like Nepal, the investment level is satisfactory but not sufficient to keep up with the population growth level. The bulk of Nepalese population involve as peasantry who lives at the verge of poverty, having a minimum propensity to save. In the absence of developed network of banking sector and industrial infrastructure, the capital hoarded hardly appears to be employed for productive purpose. The capital hoarded hardly appears to be employed of productive purposes. The capital that is in the hands of some traders is quick yielding ventures. These people are not interested making investment industries, which probably would yield a lower profit rate then what they are getting at present.

In such circumstance government fiscal measures like raising taxes are not so effective since poverty of the masses always stands as a hindrance. Public borrowing is also ineffective because people have no spare money. Even those who have it may not be interest in the customary rate of interest, and deficit financing also has its limitations. Given this brief a scenario of Nepalese economy, the role of external flow of capital particularly direct foreign investment in industries is growing everyday.

Nepal has started its effort to attract FDI since the sixth plan (1980-85). The industrial policy of Nepal (1981) has made a separate provisions relating to foreign investment. Like the developing countries Nepal is accelerating industrial development for achieving the basic goals such as high rate of growth, fulfillment of the basic needs, creation for more employment opportunities etc. It is expected that industrialization would lead to diversify the economy for the durable social, psychological and industrial framework. However, the vicious circle of poverty generally operates to restrict the formation & accumulation of capital in developing countries. One of the most important motives for industrialization is to break the vicious circle of poverty & create prosperity through the process.

Capital, appropriate technology, skilled human resources, market infrastructure & favorable administrative and legal environment are some basic requirement for rapid industrial growth. It is to be equally emphasized that those factors should be in right proportions. They are not perfect substitutes rather they are mutually related. In Nepal, many of these basic requirements are at low label or missing, disallowing the utilization of other available factors likes potential natural resources and cheap labor. As a result industrial growth could not be accelerated. Foreign investment is considered an important for the industrialization of Nepal. As it attract capital, technology skills & expertise and also help to share risks, exploit resources presently and provide access to export market.

2.2 Review of Policy

The law is a powerful instrument to bring about immediate changes in human behavior at the domestic as well as at the international level. The function of law is to define public policy, set procedures and implementation mechanisms. The government of Nepal has introduced various laws and policies in different periods for smooth flow of foreign direct investment in Nepal.

In 1974, foreign investment was allowed from 51% to 100% in the basic industries like cement, fertilizer, steel and consumer basic goods like dairy, pharmaceuticals, paper textiles etc. However, the preference in medium scale industries was given to national investors, while in large scale industries; there was a provision to treat both national and foreign investors equally (Sapkota, 2002:25).

Though, the government introduced the industrial enterprise act to attract FDI, there was not any significant flow of FDI in Nepal through 1974 to 1981. The causes behind it were the restrictive laws and policies, which the foreign investors did not find investment friendly. During these periods there was shortage of energy, which is very essential to attract FDI. Besides this, Nepal had very poor infrastructural facilities, like, roads, communication etc.

In 1981, Government of Nepal had first legislated the foreign investment law under the Foreign Investment and Technology Transfer Act. Through this act, the provision for non-nationalization of industries was guaranteed and it had also ensured the equal and the same treatment for both national and foreign investors, resembling to standard treatment norms. Foreign investors were permitted to have majority of shares in medium scale industries and to have 100% investments in large-scale industries with more than Rs 10 million investments in fixed assets (Timilsina and Mahota, 2000:32).

After the introduction of this law, FDI has increased to some extent, but the number was very insignificant. During 1981 to 1987 the total number of industries under manufacturing sector in which FDI involved was only 48. The total fixed capital contributed by FDI during these periods was Rs.1123.2 million. Similarly, at the same period of time total 26 industries were recorded in the service, tourism and other sectors in which FDI was involved. The amount of total fixed capital invested by FDI in these industries was Rs.427.8 million. But in the subsequent years of 1980, Nepalese economy experienced various macro economic crises, viz, increasing negative balance of payments, sluggish in export trade growth, high rate of inflation, growth of debt burden, budget deficit, high level of poverty and unemployment. Nepal had no alternative but to implement Structural Adjustment Program (SAP). In the SAP, Nepal could get financial assistance from World Bank and IMF. In 1980s, government of Nepal also liberalized the financial sector for joint venture and during this period Nepal-Arab Bank (1984 A.D.), Nepal Grindlays Bank (1987 A.D.) and Nepal-Indo Suez Bank (1985 A.D.) were established (Timilsina and Mahota, 2000:33).

In 1987, through the enactment of industrial policy, 50% equity investment in medium scale industries was allowed for foreign investors, which required having at least Rs.3 million investments in fixed assets, whereas in large-scale industries with the worth of at least Rs.10 million investments in fixed assets, 100% ownership was allowed. The following are the major investment incentives to the foreign investors as spelled out in the IP-1987:

1 Remittance of dividends**:** It is permitted in full in convertible currency in case of investments which have been made in the form of convertible currency or in the form of machinery or other capital goods which have been paid for in convertible foreign currency.

2 Repatriation of capital**:** Repatriation of capital on sale or liquidation is permitted in convertible foreign currency in the case of investment made in convertible foreign exchange. Repatriation is allowed at the rate of 20% per annum.

3 Employment of foreign technical personnel, in projects, is permitted with the approval of the Department of Labor.

4 Tax holiday: A five year tax holiday is given to the industries which the government has prescribed as receiving national priority, energy based industries and mineral based industries.

5 Export oriented industries are given special concessions such as exemption from custom duty, excise duty and sales tax on raw-materials used in the industry either through bonded ware house facilities or through reimbursement of levies.

6 Effective rate of protection: The industries in Nepal are offered a minimum of 30% effective rate of protection. A higher level of protection may also be granted to the industries identified as priority industries.

7 Facility of convertible currency: The industries approved by the government are provided with convertible currency for the import of plant and machinery, raw-materials and for the payment of technical service fees, royalties, management fees.

8 Other facilities: The government supplies the power required for industry on a priority basis. Special electricity charges are also fixed by negotiation for energy intensive industries deemed important from the national point of view.

After the introduction of this policy, there was significant rise in the flow of FDI than the previous years. During the period from 1987 to 1991, the total number of industries increased to 128, which has provided employment to 2974 number of people. However, SAP was continued till 1989. The flow of FDI began to come in Nepal in financial and service sector. But the flow of FDI was smallish. Most of the economists think that the effectiveness of the than laws and policies are not satisfactory. Most of them think this way because of a small size of FDI, in Nepal.

After the restoration of multiparty democratic system in the country in 1990, Nepalese economy has been more open and liberal in the matter of getting private and foreign investors involved in economic activities and consequently the private sector stimulating laws and policies have been formed. The new constitution of the kingdom of Nepal 1990 has also made some provisions in connection to foreign investment as well as participation of private institutions in investment. Industrial Enterprise Act (IEA) 1992, Foreign Investment and Technology Transfer Act (FITTA) 1992 and One Window Policy-92 are the important legislations governing the domestic and foreign investment in the country. Some features attached in the policy and FITTA are as follows:

i. 100 % investment is allowed in medium and large scale industries.
ii. Full remittance of profits, dividends and repatriation of capital is allowed.
iii. Security of foreign investment is guaranteed.
iv. Attractive facilities and concessions are given to the industries.
v. Quick and efficient service for foreign investors is promised under the one window system.

2.3 Review of Related Studies

2.3.1 Review of Articles

Bernd Stecher, in his work, 'Investment Climate, Growth and Strategy' has tried to answer three questions with regard to a favorable investment climate: what will developing countries gain, what they have to provide and how can we support them. According to him, FDI not only supplies additional capital, which is necessary to speed productivity growth, but also imports best practice management expertise and technology that has already proven its excellence in other countries and other markets. Attracting FDI thus facilitates the structural changes required for growth and helps integrate countries into the international value chain. Countries such as Ireland, Malaysia, Singapore, Thailand and now in a most impressive way, China have successfully followed the path of openness. They have attracted FDI and substantially increased their income per capita within a short period of time (Stecher, 2005:21).

According to him, to attract FDI the developing countries need to provide investors with openness and regional integration. Open borders and free entry and exist for goods, capital and businesses are relevant factors for the investment decisions of companies as these define market size and the long term allocation of their invested capital. These factors are especially important for the small countries. Developing countries should also improve their infrastructural facilities and along with this good governance is also very important. Last but not the least, there must be peace and security in the host country.

He has concluded that foreign companies can transfer management skills and technological knowledge that can easily spread among local business communities. Beyond any facilitating support and development aid from industrial countries, which is clearly necessary, the best help industrial countries can provide is to open up their markets to agricultural and manufactured goods from the developing world. But at the same time, it is the primary task of the government of any developing country to provide the framework of good governance (Stecher, 2005:23).

Manual Hinds, in his work ‘Reforming Investment Climate’ has mentioned some of the factors which are essential for attracting investment. Macro economic stability remains crucial in his opinion as the relative prices relevant for each investment must remain stable and predictable. Expatriate managers are expensive, so the availability of local managerial talent that can be trained to manage a proposed investment is a key element in the investment decision. Along with this telecommunication costs remain high in many developing countries largely because local monopolies are controlled by state owned companies, so it must be lowered down to attract investment (Hinds, 2005:14).

Kishore Sharma and Prema Chandra in their paper, ‘Foreign Investment in a least Developed Country: The Nepalese Experience aims to contribute to the literature on the development role of foreign direct investment through an examination of the Nepalese experience during the period 1988-2001. The methodology they have adopted is descriptive in nature.

According to them, Nepal has made a promising start in implementing market oriented reform and promising FDI as a part of it, but it has to go a long way in reaping the benefits from the greater global integration through FDI. Foreign firms are relatively capital-intensive as compared with the local firms. These firms employ only about 0.6% of economically active workforce which is not impressive in a labor abundant country like Nepal where about 20% of the work force is unemployed or underemployed. This low level of employment intensity in foreign firms appears to be due rigidity in labor market and shortage of semi-skilled workforce. In the absence of basic pre-requisites (namely, efficient and reliable physical infrastructure and access to semi-skilled workforce) gains from foreign firms has been rather lopsided. Most of the foreign firms are located in the Kathmandu valley or in Terai belt while hilly and mountain regions have failed to attract such investment due to poor infrastructural facilities, despite liberalization in trade and investment climate. An obvious, but important, inference coming from their analysis is that trade liberalization and generous investment per se in the absence of basic pre-conditions cannot achieve anticipated developmental objectives. Nepal obviously has intrinsic disadvantages arising from its geography in attracting FDI. However, comparative international experience suggests that her lackluster record as a host to foreign investors cannot be explained in terms of geography alone. The overall investment climate also seems to matter. The provision of required supportive services, political stability, policy certainty and a flexible administrative mechanism have an equally and perhaps even more important role to play (Sharma and Athukorala, 2004).

Bhubanesh Pant and Bama Dev Sigdel, in their policy paper published by Nepal Rastra Bank (Central Bank of Nepal) have written that it has become very competitive to attract FDI for a country like Nepal. Being a small land locked country; Nepal has to make extra efforts to counter balance the negative impact by implementing several policy measures. It has to offer more generous and attractive incentives to potential investors partly to demonstrate the fact that it has to compete with other parts of the world in attracting FDI from the same sources and in similar industries. In Nepal, there is an absence of a monitoring mechanism to accurately monitor the flow of FDI. The Board of Investment, a kind of institutional arrangement, in Sri Lanka and Bangladesh are quite sound and effective. In this respect, Nepal could learn from the experiences of these countries. Nepal has formed a Board of Investment (BOI) under the chairmanship of the Prime Minister in December, 2001. Yet, the BOI has not been carrying its due functions since its establishment. The bureaucratic rules and processes in Nepal are complicated and time consuming. The one window system has not been effectively utilized for providing proper follow up of all procedures and clearances that proposals involving foreign investments demand and also for providing stated facilities. They have recommended that to attract FDI, first of all there should be peace and security in the country. The environment of investment, in the country, is very crucial to foreign investors in making their decision to invest given that they need to stay in Nepal with their families. A poor and scary situation puts prospective investors on the sidelines. Secondly, to attract FDI Nepal should identify potential countries. The country can target FDI from South-east Asian countries such as Thailand, Malaysia, Korea, Indonesia, Singapore although a nominal amount of FDI do flow from some of these countries. Moreover, Australia and Canada have provided duty free and quota-free access to all products from the LDCs including Nepal. These two countries could be two possible FDI avenues in the long run.

Thirdly, Nepal should improve her poor physical infrastructure. At the same time there is paucity of skilled and educated labor force. Vocational and technical training programmes are poorly developed in Nepal. Hence, trained labor is a critical input while frequent labor strikes discourage investment. The country needs to ensure the supply of quality human resources to the industry, and give emphasis in improving productivity. Nepal should also learn some lessons from other countries. China is a vast potential market for foreign investors. The Chinese authorities are also aware of crucial role of technology and export-oriented investment in modernizing their economy. All foreign-owned enterprises in China are governed by a uniform tax system. A host of incentives have been provided to foreign investors. Investment climate should be developed first for smaller, domestic firms. If it improves for them, it will, in most likelihood, improve for foreign firms. Political stability in China has been strong, and this stable environment is definitely one overriding factor that has attracted investment, both domestic and foreign. In this context, Nepal could learn from the Chinese experience for formulating sound FDI policies. Lastly there must be dialogue between government and foreign investors. With the promotion of interaction between the government and the foreign investors, monitoring the activities of foreign investors should be undertaken on an annual basis that would provide important inputs on the issues to be addressed by the government or the investors (Pant and Sigdel, 2004).

Madhukar SJB Rana and Stalin Man Pradhan, in their policy paper on ‘Implementation Evaluation of FDI Policy in Nepal’, have aimed to make the investment climate in Nepal more friendly to the private sectors so as to accelerate investment outcomes by national and foreign entrepreneurs. The methodology adopted is descriptive and analytical based on documents readily available.

This paper has reached the conclusion that investment climate has deteriorated on account of severe political instability and Maoist insurgency. Private sector investment has been stagnant. There is wide lack of confidence between public and private sectors that calls for innovative institutional arrangements. Existing foreign investors find the investment climate extremely unfriendly. They feel like they are unwanted and uncared for, especially in time of insurgency and violence. Some feel highly insulted by the utter neglect on the part of Nepal government. The critical bottleneck faced by the foreign investors is the attitudinal problem amongst bureaucrats who are not genuinely open to foreign investment. There is also lack of complete communication to foreign investors. Proposed Board of Investment should provide all information to foreign investors through proposed 'One Window System'. They have recommended that peace and security and maintenance of law and order in the country should be the first and foremost agenda of the government. Experience of India and China has shown that the attraction of investment from non-resident citizens is highly important. Thus, as per the decision of NRN conference held few years ago, Nepal government should promulgate the legislation on NRN as soon as possible in order to attract the investment from Non-Resident Nepalese. They have also suggested to improve business climate for the foreign investors already in Nepal with concrete measures. The BOI should conduct regular, systematic agenda driven meetings to consult with each other.

2.3.2 Review of Thesis

Mr. Ramesh C. Chitrakar (1994), in his dissertation entitled, '*Foreign Investment and Technology Transfer in Developing Countries*' has analyzed the financial and economic performance of foreign investment and technology transfer in Nepal. The study has analyzed the foreign investors' motives of investing in Nepal, the problems they are facing and the possible ways of promoting foreign investment in the country.

Two basic methods used by him for collecting primary data on the motives of foreign investments are: mail questionnaire and interviews. The data in the study are collected in two stages. First, by mailing questionnaire to parent firms and second, by interviewing their subsidiaries in Nepal. Chi-square test has been used to test the significance of interview responses. He has found that the main problems of foreign investment are the long procedures to start a business, the small domestic market and the underdeveloped infrastructure. Lack of special incentives to the foreign investors and the non-implementation of facilities already given by the acts are other two major complaints made by foreign investors (Chitrakar, 1994).

He has recommended simplifying the procedures to start and run the business and to improve the necessary infrastructure in the country. On the whole, the study has suggested that the understanding of motives and determinants of foreign investment, solving foreign investors' problems and keeping the foreign investment policy clear and open may help to promote foreign investment in Nepal.

Mr. Madhav Raj Bhandari (2003) in his dissertation entitled, '*Foreign Investment in Nepal'* has analyzed the nature, extent, existing policies, and incentives relating to FDI in Nepal and to examine the impact of foreign investment in economic development of the country. The methodology adopted in the study is both descriptive and analytical in nature. His objectives are:

- To examine and analyze the nature and extent of foreign investment in Nepal,
- To examine existing policies and incentives relating to FDI in Nepal and
- To examine the impact of foreign investment in economic development of the country.

According to him, the most critical problems of foreign investment promotion in Nepal as perceived by the responding foreign collaborators are underdeveloped infrastructure, lack of skilled and trained human resources, small domestic market and country's land locked position.

According to him, Nepal can get benefit by improving in her physical infrastructure. At the same time it should evaluate her educational and vocational training policies in collaboration with local and foreign firms to make sure that adequate training programmes are designed to meet industry's current and future labor requirements. It should encourage the development of necessary support to those industries that provide basic machinery and parts, material inputs, components and testing services to the foreign investors. Nepal will greatly improve her chances of capturing direct foreign investment by providing better information on investment opportunities in its economy. The office of foreign investment promotion in Nepal should try to increase its promotional drive and communication with developed as well as less developed market economies about the facilities of foreign investment in Nepal. This should be done not only by arranging seminars but also by arranging discussions on firm to firm basis (Bhandari, 2003).

Mr. Rajendra Ghimire (2006), in his thesis entitled, '*Foreign Direct Investment in Nepal its Problem and Prospect'* has analyzed the nature and extent, policies adopted, incentives given for attracting foreign investment, problems of promoting foreign investment in Nepal and the motivational factors of foreign investor's decision to invest in Nepal. The methodology adopted in his study is both descriptive and exploratory in nature. His research objectives are:

- To examine and analyze the nature and extent of Foreign Investment in Nepal;
- To analyze the policies adopted and incentives given for attracting foreign investment in Nepal;
- To analyze the problems of promoting foreign investment in Nepal; and
- To analyze the motivational factors of foreign investor's decision to invest in Nepal.

Since the study is pioneer of its kind in Nepal, the study is basically an exploratory one. The analytical dimension has been given where possible. The information necessary for the study is collected both from primary as well as secondary sources. In his research work he has reached at the conclusion that there are certain motives of foreign investors investing in Nepal. The survey conducted in the study shows that the most important motivating factor for investing in Nepal is access to market by way of tariff and non-tariff restrictions imposed or expected by the government on goods planned for production. Other motivating factors affecting foreign investors' decision to invest in Nepal include the expansion program of the investing firm, locally available raw materials and low production cost. He has found that the flow of foreign investment is negligible despite the various facilities and incentives offered in Nepal. The main problems of foreign investment promotion in Nepal are the long procedures to initiate the business, non implementation of preferential treatment guaranteed by the law and underdeveloped infrastructure. His research work accepts the foreign private investment as an important vehicle for the diversification and transformation of the existing most backward agrarian Nepalese economic structure into the advanced modern economic country.

The government is suggested to increase the necessary infrastructural facilities, simplify the procedures of initiating business and reduce the bureaucratic harassment to the minimum level in order to promote foreign investment in the country. The office of foreign investment promotion in Nepal should try to increase its promotional drive and communicate with developed as well as less developed market economies about the facilities of foreign investment in Nepal (Ghimire, 2006).

Mr. Nabin Sharma (2007) in his study entitled, *'A Study of the Impact of Foreign Direct Investment and Technology Transfer in Nepal: with special reference to the Indian joint ventures'* has analyzed the recent trends in investment policy of both India and Nepal, structure of FDI with reference to India's joint ventures in Nepal and explore new areas of joint ventures that would be beneficial to both the countries. This study is based on primary as well as secondary data. Primary data is based on opinion survey of experts, government officials and organizations with regard to identify problems and prospects of Nepal-India joint ventures. The methodology adopted in his study is both descriptive and exploratory in nature. He has centered around the following objectives:

- To review the recent trends in investment policy of both India and Nepal;
- To analyze the structure of FDI with reference to India's joint ventures in Nepal; and
- To explore new areas of joint ventures that would be beneficial to both the countries.

He has concluded that in a poverty stricken economy like Nepal where internal resources are extremely limited, not enough to supplement current expenditures, and dependence on 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 foreign direct investment is crucial not only to sustain development activities but also for poverty alleviation. Investment climate in Nepal is moderately fair and its strengths are: location between the two potentially largest markets in the world- china and India; macro economic stability and a relatively liberal economy; trainable and low cost workforce; substantial natural and cultural assets; and a small and accessible bureaucracy and a generally business-friendly Government. The opportunities are: tourism; including sports and adventure tourism, health tourism and cultural tourism; a variety of niche agricultural and agro-business activities; hydropower generation and IT-based services. Major weaknesses comprise of landlockedness, poor infrastructural facility and mostly unskilled workforce, rigid legislation, political instability, weak implementation and persistent corruption, followed by ongoing insurgency. So, to attract FDI, it is essential to liberalize further foreign investment policies, ensure peace and security and political stability in the country and to initiate economic diplomacy through Royal Nepalese Embassy. There is also need for initiating joint studies to identify economically viable projects with regard to Nepal-India joint ventures. Thus, Nepal should develop forward-looking approach to attract FDI from all over the world and more pertinently from India. However, foreign investment policies in Nepal are relatively inward-looking, requiring adjustment with small and cottage industries and industries of national importance. Review is imperative in some areas where FDI is barred. It is also essential to improve the capacity of domestic industries ensuring competition as per the provisions made by WTO and SAFTA (Sharma, 2007).

Mr. Surendra Karki (2007) in his research study entitled, *'A Study of Trend and Structure of Foreign Direct Investment in Nepal'* has analyzed the trends, structure, identification of leading factors causing in FDI and aims to suggest mechanism to combat with FDI problems. This study is based on secondary data. The methodology adopted in his study is both descriptive and analytical in nature. The major objectives of this study are-

- To analyze the trend and structure of foreign direct investment in Nepal.
- To identify leading factors causing in FDI and aims to suggest mechanism to combat with FDI Problems

- To analyze the existing laws and policies relating to foreign direct investment in Nepal.
- To suggest the way of promoting foreign investment in Nepal.

He has concluded that in year wise flow of FDI from the year 1980 to 1987 shows only a modest rather fluctuating foreign investment both in terms of total fixed capital and authorized capital, although authorized capital is in no way an important indicator of investment. The total numbers of industries registered in the manufacturing sector between the years 1980 to 1987 were 48, which involved the total fixed capital of Rs.1123.2 million and in the service, tourism and other sectors registered 26 industries, which involved the total fixed capital of Rs.808 million. Thus, the study shows that the number of industries established under FDI was very insignificant during these periods. One of the main causes behind this slow increment might be the restrictive laws and policies adopted by the government. The policies were not investment friendly. In the subsequent period of 1980s Nepalese economy was suffering from various macro economic crisis like increasing negative balance of payment, high rate of inflation, growth of debt burden, budget deficit etc, due to which it was difficult to attract FDI in Nepal. The size of FDI was confined to Rs.1209.95 million in 2001/02. During the last twelve years between 1991/92 to 2005/06 trends in FDI were found to be erratic, jumping from Rs.688.9 million in 1991/92 to Rs.3585.90 million in 1995/96, and for the next two consecutive years it declined. And then in 1997/98 it started to increase and this trend lasted only for two years. Again FDI continued to decline for three consecutive periods between 2000/01 to 2002/2003. Take off in FDI was further visualized in 2003/04. However, FDI has decelerating trend in recent years that confined to Rs.311.08 million in 2005/06.

He concluded that the flow of FDI projects in the beginning of 1990s was encouraging. The main cause behind this was the incorporation of various facilities in the Foreign Investment and Technology Transfer Act (FITTA-92), and Industrial Enterprise Act (IEA-92), which were not in existence prior to 1992. In these acts various facilities like, repatriation facilities, visa facilities, various tax incentives, convertible foreign exchange facilities, land facilities were offered to foreign investors and hence foreign investors have shown interest in investing in Nepal in the early 1990s. From his study, what we infer is the intensity of foreign direct investment in terms of either capital investment or foreign investment or employment generation is concentrated in the eighth five year plan period except in number of industries in the ninth five year plan. This indicates that political stability; national consensus and maintenance of peace and security are the foremost preconditions for the foreign direct investment to flow in any country. Although labor is cheap in Nepal, labor productivity is very low. Labor productivity can be improved by making stringent labor laws. Labor wages should be based on performance and productivity. Currently, once a labor is employed for 180 days, he is permanent and cannot be dismissed even if he is unproductive. So, labor laws should be re-designed.

Hardly any promotional measures to publicize Nepal as a potential country for FDI have been undertaken. This has inhibited the flow of FDI into Nepal. The majority of international investors have little idea about the prospects of joint-venture industries in Nepal. In order to resolve this problem, different promotional measures should be initiated to publicize the prospects and potential of foreign/joint-venture investments in Nepal and the policy reforms undertaken by the Nepalese Government in this regard. Publicity measures such as advertisement in the television and magazines, exhibitions, and trade fairs should be utilized every now and then in major cities of the world where prospects of FDI prevail. In this respect ministry of foreign affairs and Nepalese diplomatic missions have an instrumental role to play in image building and promotion. Information relating to the investment opportunities in Nepal, the facilities provided to the investors, and the possible benefits to the investors owing to the potential resources in Nepal should be disseminated. FDI can also be flowed into the country from Non-Resident Nepalese (NRNs). With regard to attracting FDI from Non-Resident Nepalese (NRNs), the budget for FY 2002/2003, for instance, stated that steps would be taken to simplify the licensing procedures and repatriation from such investment in the currency of investment. The provision of ten year multiple entry visa to NRNs willing to invest in Nepal has already been made effective. Still, separate laws should be devised to attract investment from NRNs. The law and order situation is very crucial to foreign investors in making their decision to invest given that they need to stay in Nepal with their families.

Security concerns about themselves and their families are an important factor. A poor law and order atmosphere puts prospective investors on the sidelines. So, there must be the fearless situation for investors. For this government can play an important role. The attraction of FDI has become very competitive. Being a small landlocked country, Nepal has to make extra efforts to counter balance the negative impact of the competition by implementing several policy measures. It has to offer more generous and attractive incentives to potential investors partly to demonstrate the fact that it has to compete with other countries. On the investors' side, apart from attractive incentives, they also consider other factors such as political stability, sound macroeconomic policies, continuity in government policies, adequate infrastructure facilities, equal treatment of foreign and local firms.

CHAPTER TWO

RESEARCH METHODOLOGY

Research methodology is the systematic way of solving research problems. Research methodology refers to the overall research process, which a researcher conducts during his/her study, if all the procedures from theoretical foundation to the collection and analysis of data. As most of the data are quantitative, the research is based on the scientific models. It is composed of both parts of technical aspect and logical aspect. On the basis of historical data, research is systematic and organizational effort to investigate a specific problem that needs a solution. This process of investigation involves a series of well thought out activities of gathering, recording and analyzing and interpreting the data with the purpose of finding answer to the problem. Hence, the entire process by which we attempt to solve the problem is called research (Kothari, 1994:56).

3.1 Research Design

The research design refers to the entire process of planning and carrying out a research study. As the objectives of the present study are to examine the overall structure and trend of FDI in Nepal, to review the various laws and policies relating to FDI, so the type of the research design covered in this study are both descriptive and analytical in nature. Being a fact finding research, it has not set any hypothesis to be tested.

3.2 Sources of Data

Data necessary for the study are collected mainly from secondary sources. For this study, first of all the policies and acts relating to the foreign investment in Nepal are studied seriously. Publications, books, journals and articles etc are studied to understand the basic concepts of foreign direct investment. Researcher collected the data mainly from Department of Industry, Ministry of Finance, Quarterly Economic Bulletin published by Nepal Rastra Bank (Central Bank of Nepal), Ninth and Tenth five year plan from National Planning Commission, different journals published by Federation of Nepalese

Chamber of Commerce and Industry, literature relating to theories of FDI from British Council, various investment reports published by United Nations from UN library, various dissertations on FDI from Tribhuvan University Library, and books published on FDI from Centre for Economics Development and Administration Library. In addition to this, the sources have been collected from various published magazines, newspapers, different economic journals and from some of the web sites.

3.3 Statistical Tools Used

Researcher has used some of the statistical tools for the clarity of subject matter. Various tables have been employed along with the graphical presentation of the data in the places where they are required.

3.4 Data Processing and Analysis

In this study, FDI is considered as one of the important sources of growth and development. After collecting the data from different sources, data are arranged in a systematic way and tabulated in accordance with the need for the study. Analytical part of the study is divided into two sections. Section A of the study consists of describing laws and policies relating to FDI. The rules and regulations (laws) of the Nepal government in connection to FDI and their impact are analyzed in chronological order to find the role of the government in enhancing FDI in Nepal by creating suitable foreign investment atmosphere.

Section B of the study consists of the systematic presentation of the year wise, status wise, category wise, country wise and plan wise flow of FDI in Nepal. Facts are arranged systematically as obtained through secondary sources with the help of ratios, percentage and graphs to make them comparable and explanatory. The analysis is based on time series data of 20 years covering the period from 1985 to 2005. The compiled data have been processed with the help of computer for analysis. Year wise flow of FDI is shown to see the trend of FDI in Nepal from 1980 to 2005. Similarly status wise flow of FDI is presented to see the number of FDI projects which are operating, under-construction, cancelled or closed till now. Sector wise flow of FDI gives us the information about the flow of FDI into Nepal in different sectors of the economy. The flow of FDI from India and other countries are presented in simple tables in attaining general and special objectives of this study.

3.5 Definitions of Some of the Major Terms Used in the Study

FDI: According to the second edition of encyclopedia of economics, FDI is the acquisition of managerial control by a citizen or corporation, of a home nation over corporation of some other host nation. Corporation that widely engage in FDI are called, “Multinational Companies”, “Multinational enterprises”, or “Transnational Corporation”.

Foreign Investment and Technology Transfer Act (FITTA)-1992 defines ‘foreign investment’ as investment made by a foreign investor in any industry in the form of share (equity), reinvestment of the earnings derived from the investment and investment made in the form of loan or loan facilities.

The term industry is defined in the Industrial Enterprises Act (IEA) 1992. According to section 3 of the IEA 1992, industries are classified as a. manufacturing industries b. energy-based industries c. agro and forest based industries d. mineral industries e. tourism industries f. service industries g. Construction industries.

The term ‘technology transfer’ is defined in section 2 of FITTA as any transfer of technology to be made under an agreement between an industry and a foreign investor on the following matters: a. use of any technological right, specialization, formula, process, patent or technical know how of foreign origin b. use of any trade mark of foreign ownership c. providing any foreign technical, consultancy, management and marketing service.

The term ‘foreign investor’ is defined as any foreign person, firm, company or corporate body, government or international institution, which has invested money or technology transferred.

According to the UNCTAD-99, ‘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.’

FDI may also be defined into direct and portfolio investment. Portfolio investment refers to the participation in overseas investment without any control over running of business. It involves the purchase of loan stock or shares in an overseas organization. Direct investment refers to a lasting investment in an enterprise in an economy where the investor’s purpose is to have an effective force in the management of the enterprise as well. Such investment usually arises from the acquisition of an overseas branch and subsidiary. The fact that the investor has substantial control over the foreign subsidiary enterprises makes direct investment more complex in nature than portfolio investment. A controlled subsidiary often receives direct inputs of managerial skills, trade secrets, technology, rights to use brand names and instructions about which markets to pursue which to avoid.

Multi National Company (MNC) is defined as a corporation or enterprise that conducts and controls productive activities in more than one country.

Home country is defined as the FDI investing country.

Host country is defined as the FDI receiving country.

Trans National Company (TNC) is a synonym of Multi National Company (MNC) known as Global Corporation or International Corporation.

CHAPTER FOUR

PRESENTATION AND ANALYSIS OF DATA

This chapter incorporates the analysis of FDI in Nepal. Analysis is divided into three parts. First part deals with the analysis of government laws and policies in the pre-democratic and post democratic period while the second part deals with the analysis of data relating to FDI and third part deals with the analysis of primary data obtained from survey results.

4.1 Analysis of Government Laws and Policies

4.1.1 Laws and Policies in the Pre-democratic Period

The law is a powerful instrument to bring about immediate changes in human behavior at the domestic as well as at the international level. The function of law is to define public policy, set procedures and implementation mechanisms. The government of Nepal has introduced various laws and policies in different periods for smooth flow of foreign direct investment in Nepal.

In 1974, foreign investment was allowed from 51% to 100% in the basic industries like cement, fertilizer, steel and consumer basic goods like dairy, pharmaceuticals, paper textiles etc. However, the preference in medium scale industries was given to national investors, while in large scale industries; there was a provision to treat both national and foreign investors equally (Sapkota, 2002).

Though, the government introduced the industrial enterprise act to attract FDI, there was not any significant flow of FDI in Nepal through 1974 to 1981. The causes behind it were the restrictive laws and policies, which the foreign investors did not find investment friendly. During these periods there was shortage of energy, which is very essential to attract FDI. Besides this, Nepal had very poor infrastructural facilities, like, roads, communication etc.

In 1981, Government of Nepal had first legislated the foreign investment law under the Foreign Investment and Technology Transfer Act. Through this act, the provision for non-nationalization of industries was guaranteed and it had also ensured the equal and the same treatment for both national and foreign investors, resembling to standard treatment norms. Foreign investors were permitted to have majority of shares in medium scale industries and to have 100% investments in large-scale industries with more than Rs 10 million investments in fixed assets (Timilsina, and Mahato, 2000).

After the introduction of this law, FDI has increased to some extent, but the number was very insignificant. During 1981 to 1987 the total number of industries under manufacturing sector in which FDI involved was only 48. The total fixed capital contributed by FDI during these periods was Rs.1123.2 million. Similarly, at the same period of time total 26 industries were recorded in the service, tourism and other sectors in which FDI was involved. The amount of total fixed capital invested by FDI in these industries was Rs.427.8 million. But in the subsequent years of 1980, Nepalese economy experienced various macro economic crises, viz, increasing negative balance of payments, sluggish in export trade growth, high rate of inflation, growth of debt burden, budget deficit, high level of poverty and unemployment. Nepal had no alternative but to implement Structural Adjustment Program (SAP). In the SAP, Nepal could get financial assistance from World Bank and IMF. In 1980s, government of Nepal also liberalized the financial sector for joint venture and during this period Nepal-Arab Bank (1984), Nepal Grindlays Bank (1986) and Nepal-Indo Suez Bank (1985.) were established (Timilsina, and Mahato, 2000).

In 1987, through the enactment of industrial policy, 50% equity investment in medium scale industries was allowed for foreign investors, which required having at least Rs.3 million investments in fixed assets, whereas in large-scale industries with the worth of at least Rs.10 million investments in fixed assets, 100% ownership was allowed. The following are the major investment incentives to the foreign investors as spelled out in the IP-1987:

Remittance of dividends: It is permitted in full in convertible currency in case of investments which have been made in the form of convertible currency or in the form of machinery or other capital goods which have been paid for in convertible foreign currency.

Repatriation of capital: Repatriation of capital on sale or liquidation is permitted in convertible foreign currency in the case of investment made in convertible foreign exchange. Repatriation is allowed at the rate of 20% per annum.

Employment of foreign technical personnel, in projects, is permitted with the approval of the Department of Labor.

Tax holiday: A five year tax holiday is given to the industries which the government has prescribed as receiving national priority, energy based industries and mineral based industries.

Export oriented industries are given special concessions such as exemption from custom duty, excise duty and sales tax on raw-materials used in the industry either through bonded ware house facilities or through reimbursement of levies.

Effective rate of protection: The industries in Nepal are offered a minimum of 30% effective rate of protection. A higher level of protection may also be granted to the industries identified as priority industries.

Facility of convertible currency: The industries approved by the government are provided with convertible currency for the import of plant and machinery, raw-materials and for the payment of technical service fees, royalties, management fees.

Other facilities: The government supplies the power required for industry on a priority basis. Special electricity charges are also fixed by negotiation for energy intensive industries deemed important from the national point of view.

After the introduction of this policy, there was significant rise in the flow of FDI than the previous years. During the period from 1987 to 1991, the total number of industries increased to 128, which has provided employment to 2974 number of people. However, SAP was continued till 1989. The flow of FDI began to come in Nepal in financial and service sector. But the flow of FDI was smallish. Most of the economists think that the effectiveness of the than laws and policies are not satisfactory. Most of them think this way because of a small size of FDI, in Nepal.

4.1.2 Laws and Policies in the Post Democratic Period

After the restoration of multiparty democratic system in the country in 1990, Nepalese economy has been more open and liberal in the matter of getting private and foreign investors involved in economic activities and consequently the private sector stimulating laws and policies have been formed. The new constitution of the kingdom of Nepal 1990 has also made some provisions in connection to foreign investment as well as participation of private institutions in investment. Industrial Enterprise Act (IEA) 1992, Foreign Investment and Technology Transfer Act (FITTA) 1992 and One Window Policy-92 are the important legislations governing the domestic and foreign investment in the country. Some features attached in the policy and FITTA are as follows:

1. 100 % investment is allowed in medium and large scale industries.
2. Full remittance of profits, dividends and repatriation of capital is allowed.
3. Security of foreign investment is guaranteed.
4. Attractive facilities and concessions are given to the industries.
5. Quick and efficient service for foreign investors is promised under the one window system.

A. Facilities and Concessions

Facilities, incentives and concessions are some of the most important aspects for foreign investment and technology transfer. Various acts, the FITTA 1992 and IEA 1992 have provided a wide range of facilities, incentives and concessions for foreign investors.

Pursuant to section 15 of IEA, foreign investors were supposed to enjoy the following concessions:

1. No Sales Tax (VAT), excise duty and income tax shall be levied for the cottage industry;
2. Not more than 20 percent income tax shall be levied on the income earned from industries excluding certain industries i.e. cigarettes, bidi (local cigarettes made by raw tobacco and leaf), cigar, khaini (moisturized dust of tobacco), tobacco, alcohol or beer and tobacco as being chief raw-material;
3. an income tax exemption at the rate of ten percent will be granted to industries utilizing 80 percent or more of local raw materials and 100 percent local manpower. However, cigarettes, bidi, cigar, tobacco, khaini, alcohol or beer, saw–mill or other raw industries are exempted from this facility;
4. 50 percent income tax exemption is granted to the national priority industries, engaged in transportation sector (i.e. road, bridge, tunnel, ropeway, flying bridge, trolley bus and tram manufacturing and operation) for ten years from the operating year, and 7 years for other industries listed in the schedule;
5. industries other than cigarettes, bidi, cigar, khaini, tobacco, alcohol or beer established in the remote, underdeveloped and relatively developed areas are entitled to grant a rebate of 30, 25 and 20 percent of income tax and 35, 25 and 15 percent of excise duty respectively for a period of 10 years, from the date of operation;
6. fruit processing, cider and wine industries with a fix asset of up to two million five hundred thousand rupees established in some remote districts will be conferred to an excise duty and sales tax exemption for a period of 10 years, and it is total eight years in case of fruit-based alcohol industries;
7. while calculating depreciation on the fix assets, industries will be entitled to add one-third of the rate of depreciation allowed under the existing income tax laws;
8. if an industry diversifies itself through reinvestment in the same or in any other industry or expands its installed capacity by 25 percent or more, modernizes its

technology or develops ancillary industries, it will be entitled to a reduction of 40 percent of new additional fix assets from its taxable income;

9. 50 percent of taxable income could be deducted for the investment of an industry which try to minimize or control pollution. Such remission may be deducted on a lump sum or on an installment basis within a period of three years;
10. pre-operation costs incurred by industries with regard to skill development training is allowed to be capitalized;
11. after an industry comes into operation 10 percent of the gross profits shall be allowed as a deduction against taxable income on account of expenses related with technology, product development, and efficiency improvement;
12. dividend income is exempted from income tax;
13. 5 percent of gross income profit against net taxable income could be deducted for advertisement, promotion services or hospitality etc;
14. 5 percent of gross income may be deducted from income tax for donation to any school, college, university, hospital, religious place or social activity;
15. percent income tax exemption will be granted in a year to an industry providing direct employment to 600 or more people in that year;
16. customs duties, sales tax, excise duties and premiums on raw materials and auxiliary raw materials of export-oriented industries will be reimbursed within 60 days from the date of application;
17. no income tax will be levied on profits earned through export;
18. amount of expenditure made by an industry for the permanent welfare of its workers is deductible from the computation of income tax;
19. rate of custom duty is not allowed to exceed to the import of principle raw material than produce imported from such raw material;
20. amount of sales tax and customs duty paid by an industry producing the intermediate goods while selling it to another industry is adjustable to the income tax;

In addition to all these incentives and concessions, section 16 of IEA provides the following non-tax incentives:

1. forest-based industries may be made available any forest on leasehold basis;
2. royalties will not be levied on the industry generating electricity for its use;
3. additional facilities and concessions may be granted by Nepal government to the industries established in the Export Processing Zones (EPZ) and in the industrial estate as well as to the national priority industries or any industry established in Nepal by way of invention therein; and
4. double sales tax shall not be levied on the raw materials and products of any industry.

The Income Tax Act 2001 and its regulations define income tax, set procedures, and provide implementation mechanism. Similarly, the other acts such as Sales Tax (VAT), Custom Duty Act, and Excise Duty Act also make same provisions. The Company Act 1997 defines company, set procedures to register a company and conduction of company.

B. Process of Permission

Permission is one of the important requirements for foreign investment and technology transfer. A foreign investor cannot carry out any business without the permission of the government of the host country. Permission of the department of industries is required for investment or technology transfer. Permission can obtain from DOI and/or the Industrial Promotion Board within 30 days of application. If the total property of the industry is less than Rs. 50 crores, the DOI gives permission and if the total property is higher than 50 crores the IPB gives permission. In accordance with the given Foreign Investment and Technology Transfer Act, a foreign investor should have to obtain these permissions from the concerned department and fill a form for foreign investment which is given in appendix-l. However, there are some of the items which are kept in the negative list, where foreign investment is not allowed, this list is given in appendix-II. Following are the basic permissions, which are supposed to be obtained by a foreign investor:

Permission of the Department shall be required to be obtained for foreign investment or technology transfer.

1. A person desiring to avail the foreign investment or technology transfer shall be required to make an application to the department in the prescribed particulars for obtaining permission in that behalf.
2. If an application is made pursuant to sub-section (2) above, the department shall, as per the decision of the board, grant permission in the prescribed format within thirty days from the date of application, if the Board decides not to grant permission for the establishment of the industry, the department shall inform the applicant of such decision.
3. Not withstanding anything contained in sub-sections (1) and (2) above, no permission shall be granted for making foreign investment in the industries set forth in sub section 3, permission may be granted for the transfer of technology in certain prioritized industries.

C. Repatriation Facility

As per FITTA, 1992, a foreign investor making investment in Nepal shall be entitled to repatriate the following amounts from the kingdom of Nepal:

1. the amount received by sale of the whole or any part of the equity investment;
2. the amount received as profit or dividend from the investment;
3. the amount received as per merit of principal and interest on any foreign loan;
4. the foreign investor or a foreign technology supplier is also entitled to repatriate the amount received under the agreement for the technology transfer in such currency by the DOI.

A foreign national working in any industry with prior approval of the Department of Labor and who is from a country where convertible foreign currency is in circulation may repatriate salaries, allowances, emoluments etc in convertible currency in an amount not exceeding 75% of such salaries, allowance and emoluments. To obtain the repatriation facility, the foreign investor or the technology supplier or the foreign expatriate or the concerned company must obtain a recommendation from the DOI.

I. Repatriation of Sales of Shares

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 with the following documents:

1. Proof of investment made and number of shares owned (the proof of investment could be a certificate from the commercial bank through which the investment was brought into Nepal).
2. Letter from the company stating the completion of the transfer of the related shares duly certified by the CRO or such other body.
3. Prior approval of DOI, if the share was transferred to any foreign national.
4. Custom declaration form and the approval letter if the investment was made in the form of plant, machinery and equipment.
5. Copy of the Board of Directors' resolution.

II. Repatriation of Dividend

Any foreign investor, wishing to repatriate his dividend from his investment as per the FITTA (1992) has to obtain a recommendation from the DOI. The foreign investor or company has to apply to the DOI with the following documents:

1. Documentary proof of the investment made which is issued by the commercial bank. This document is needed only for the first time and again only when the investor makes further investment.
2. Custom declaration certificate of the import of plant, machinery and equipment of the investment by the foreign investor that has been made in the form of capital equipment.
3. Auditor's report including balance sheet and profit and loss account.

4. Proof of dividend declaration.

III. Repatriation of Loan and Interest

The industrial unit with foreign loan has to apply to the DOI for sending out the principal and interest on the foreign loan obtained with the approval of DOI along with the following documents:

1. Certificate from the commercial bank regarding the transfer of the loan amount into Nepal.
2. Custom declaration certificates and invoice of the plant machinery if the loan was obtained in the form of machinery.
3. Date of approval of the loan arrangement.

IV. Repatriation of Technology Transfer Fee

The industrial unit with the approval of technology transfer agreement, trademark license agreement, management agreement and technical assistance agreement can apply to the DOI for the transfer of fee as per the agreement.

V. Repatriation of the Salaries and Allowances of the Expatriates

For the repatriation of salaries, allowances and emoluments received by the expatriate, the industry has to apply to the DOI for recommendation along with the following documents:

1. Work permit issued by the Department of Labor.
2. Document showing the amount of salary and allowances received during the period for which the repatriation is sought.

D. Visa Facility

Section 6 of FITTA has managed to issue three types of visa for the foreign investors wishing to invest in Nepal. These include:

A non tourist visa has been managed to provide for foreign investors wishing to visit in Nepal for the purpose of undertaking study or carrying out any research with the objectives of making investment in Nepal.

A business visa for a foreign investor and his dependent family or his authorized representative and dependent family of such authorized representative is managed to provide for the period till his investment in the industry is retained.

A residential visa for a foreign investor and his dependent family who at a time, makes the investment worth of at least US dollar of one hundred thousand or in convertible foreign currency equivalent thereto is managed to provide for the period until such investment is retained.

E. Industrial Manpower

Industrial manpower is one of the significant aspects of industrial development. Without skilled and or semi-skilled manpower, industrial development cannot be done. Pursuant to section 22 of IEA, foreign investor should employ Nepalese citizens necessary to the industry. However, if foreign technical personnel are required to any industry, the foreign investor can employ foreign technicians for a period of 5 years with the approval of the Department of Labor. The term of employment can be extended to an additional 5 years. The foreign personnel are permitted to repatriate up to 75 percent of their salaries and allowances in convertible currency (section 22 of IEA).

F. Non-nationalization of Industries

Security of investment is one of the important matters in relation to foreign investment. Section 21 of IEA-1992 has made a clear provision on non-nationalization of industries whether the Nepalese or foreign nationals establish them. In this regard, Nepal has signed bilateral investment treaties with India, Britain, Germany and Norway. Nepal is also a member for the Multilateral Investment Guarantee Agency (MIGA) since 1993. The Multilateral Investment Guarantee Agency was established in 1988 as the newest affiliate of the World Bank group. MIGA’s principle mandate is to enhance the flow of FDI to its developing member countries, through a wide range of support services which is delivered through two distinct, yet supportive and complementary instruments: policy advisory/promotional services and long term political risk insurance.

MIGA’s promotional services aim at to create a dialogue between the international business community and policy makers, as well as with national private investors in developing member countries. To encourage this dialogue, MIGA organizes promotional conferences in developing member countries. These conferences are generally country specific and designed to meet the particular objectives of the country concerned. MIGA’s strength lies in its ability to provide advisory promotional and political risk insurance services to member countries as an integrated package and coordinated strategy to attract FDI to developing countries. MIGA provide guarantees to foreign investors against non-commercial risks like currency transfer, expropriation, breach of contract and war and civil disturbance in the host country. Besides this, the statutory provision of Nepal itself sufficiently guarantees the security of investments. No industries will be nationalized. Nepal has also signed Reciprocal Encouragement and Protection of Investment Agreement with France, the Federal Republic of Germany and United Kingdom. Nepal is also under way to conclude such agreements with other countries as well. Under these agreements, investments enjoy full protection and security.

G. Arbitration

Settlement of dispute is also an important aspect in the field of foreign investment and technology transfer. Many disputes may arise between a foreign and national investor, between a foreign investor and local people, between a foreign investor and workers, between a foreign investor and the government of the host country. The government of Nepal has established some written solutions for settling possible disputes that are related to the foreign investment and technology transfer sector of Nepal. They are as follows:

1. If the foreign investor, the concerned industry and the department of industry fail to settle among themselves any dispute concerning foreign investment, it will be settled by arbitration.
2. Arbitration will be held according to the prevalent arbitration rules of the United Nations Commission for International Trade Law (UNCITRAL).
3. The arbitration will be held in Kathmandu.

Pursuant to section 5 of the Arbitration Act 1998, if there is no mention about the number of arbitrator in agreement, there will be three persons in arbitration. Each party can appoint one arbitrator and the arbitrators appointed by the parties shall appoint another arbitrator and shall work as chief arbitrator. If there is no provision about the arbitration in the agreement, concerned appellate court can appoint 3 arbitrators upon request of the parties' concerned (sec.6). The other matters regarding the arbitrators such as powers, qualification and removal of arbitrator and procedures of arbitration etc are mentioned in the Arbitration Act, 1998.

H. Measures for Environmental Protection

While promoting industries, Nepal government has initiated environmental considerations to achieve sustainable industrial growth and development. Industrial Policy 1992 and Industrial Enterprises Act 1992 require taking permission for the establishment and operation of pollution prone industries in the country. However, the IEA has been amended in 1997 and this provision has been incorporated under the new legislation of Environmental protection Act (EPA) and Environmental Protection Regulation (EPR). The EPA and EPR 1997 make it compulsory to undertake environmental assessment before the establishment of an industry.

I. Convertible Foreign Exchange Facility

The Act has provided with the convertible foreign exchange facility for importing necessary machinery, 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.

J. Land Facilities

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 relaxed. Any business parties who incorporate a company in the kingdom of Nepal has right 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.

4.1.3 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, harassing and corrupt administration of the government in service delivery system in Nepal was barrier in the path of industrialization process before implementing 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:

1. 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.
2. Describing all facilities and concessions to the industries in the letter of permission.
3. Granting permission within 21days after the submission of application in the Department of Industry.

4.1.4 Impact of these Policies in the Post Democratic Period

Various policies were thus introduced to attract FDI in Nepal after 90s, but the amount of FDI that Nepal has received is relatively small and therefore its impact on the economy is meager. Impacts of these policies in the economy are as follows:

1. The Foreign Investment and Technology Transfer Act 1992 govern the entry of FDI in Nepal. In the first half of the 90's, there was significant rise in the foreign investment in the country, which was mainly due to the relatively liberal policies than the previous ones and various facilities and incentives provided in FITTA-92 and IEA-92. After the introduction of these policies, there is distinct rise in the volume of FDI was realized. As compared to the annual average flows of $0.3 million during 1980-90, the average flow of FDI during 1991-2001 was $ 9.5 million per annum. The FDI inflows into the country show a peak of $23.1 million in 1997. In the first half of the 90s, the foreign investment flowed in a good amount, but after 1996, it began to decline due to Maoist insurgency and political instability in the country. During 1992/93, total number of the projects recorded under foreign investment was 64, which became able to provide employment to 13873 people of the country. Till January, 2005, the total number of FDI projects is 935, which has given employment to 98024 people. Total foreign investment in these projects till now is Rs.25681.66 million. Total project cost till January, 2005 is Rs.88904.27 million and the value of total fixed cost is Rs.74014.69 million. Most of the FDI are flowing into the manufacturing sector. Till now 440 projects under FDI are recorded in this sector, which have been

accounted for half of the total employment opportunities generated by FDI industries. Tourism, service and energy based FDI industries altogether have one–third of that employment. Tourism sector which is Nepal's second largest recipient of FDI is an important source of foreign exchange earning (Department of Industries, 2005).

2. With the initiation of open and liberal policy in the financial sector since the fiscal year 1990/91, numbers of joint venture banks have thronged into the financial market. As such, the number of commercial banks has reached 11 including Nepal Bank Limited and Rastriya Banijya Bank (Nepal Government owned banks). The total number of commercial bank branches operating in different parts of the country now stands at 460. Despite the increase in number, the joint venture banks are concentrated in urban centers, especially in major cities, with all their headquarters in Kathmandu alone, except that of Nepal Sri Lanka Bank, which is based in Rupandehi, Nepal (Timilsina, 2000).
3. FDI in Nepal is much more contributed by individual foreign investors than corporate business enterprises. Out of 292 FDI enterprises operating in Nepal since Mid-May 2002, almost half of them have been operating under the investment of individual ownership. By mid July 2001, 7 commercial banks, and 4 finance companies are operating in joint venture. Similarly there are 6 insurance companies established under the joint venture.
4. Since April 2002, 86% of FDI enterprises have made equity investment only and 7% of the enterprises have made investment in technology transfer only, while the rest have constituted both types of investments together. This gives the clear indication that most of the foreign investors so far prefer equity investments only (FNCCI, 2002).
5. Until the mid-April 2002, 65% of foreign enterprises have been registered as small-scale enterprises. Medium scale enterprises constitute 21% of the total FDI enterprises, whereas large enterprises share only 14% of the total FDI industries.
6. After the introduction of this policy various countries have shown their interest to invest in the country. A total of 48 countries were FDI sources, in which China,

Japan and USA have followed India. India alone has invested 46.2 percent projects in manufacturing sector. Although in FITTA-92, some visa facilities were given, these policies have not been implemented out properly. Prospective investors have to make frequent travel back and forth and the system of single and double entry is a hindrance. The process through which the repatriation of capital and dividends is conducted must be made more simple and transparent (FNCCI, 1998).

7. Total merchandise exports from Nepal grew by 170% between 1990/91 and 1999/2000, compared with a mere 12% increase from the fiscal years 1980/81 to 1989/90. The annual average growth of exports was 14.3% for the years 1990 to 1999, compared with 3.9% for the period 1980/89. Much of the growth in exports has been concentrated in textiles and garments, the second largest FDI manufacturing sub-sector. By the fiscal year 1999/2001, readymade garments were the largest single merchandise export, contributing nearly 60% of convertible foreign exchange earnings from merchandise exports. Products which are experiencing fast export growth to India include toothpaste, vegetable oil, soap and ayurvedic healthcare products. This largely attributed to Indian joint ventures operating in Nepal (UNCTAD, 2003).

8. Under the new trade policy 1992, imports of raw materials, consumer goods, industrial machinery and services were made free. Market rate determination of the exchange rate of national currency helped the exporters to be more competitive in the employment in international market.

9. There were some changes in the macro economic indicators due to the introduction of macro policies. After 90s, the GDP growth rate had averaged around 4.4 % per annum as compared to 4.2 % per annum before 90s. Average saving rate increased from 10.64 % in 1980s to 13.8 % in 90s (Sapkota, 2002).

10. One Window Policy as such is logically attractive policy under which One Window Committee has been constituted for one window service delivery of registration, land, electricity and water to the investors. In general, the foreign investors haven't access to such basic services as stated in the policy because of the problem of proper functioning of One Window Committee and its ad hoc

administration. The one window system needs to be reassessed and made more effective for providing infrastructure and services.

11. Some of the tax facilities provided in these policies have contributed to total tax revenue to the government with additional tax net of approximately Rs.52.8 million per annum that was 0.2 percent in total tax revenue (Rs.28284.5 million) but 9.5 percent in total corporate income tax (Rs.551.01 million). It is very encouraging that the entry of FDI industries has also increased sources of corporate income tax. Development activities and poverty reduction program can be financed for higher economic growth (Bista, 2005).
12. FDI is the vehicle for the transfer of technology to ensure growth. It is assumed that transfer of technology would be possible with the increase in FDI. After the introduction of FITTA-92, the process of technology transfer has increased largely. With the establishment of Joint Ventures, labor intensity of products and services has started to decline. However, in the absence of the concrete national training policy and Human Resource Development (HRD) policy of the government, investments of the big companies are limited to a small extent. Critical skill is required due to which industrial growth is lacking. In Nepal, in recent years some of the enterprises run internship programs to train the local work force. For Example, Hotel Taragaon Regency (Hyatt) runs an internship program titled “Learn and Earn Program”, under which some 200 persons have been given training. Himal Power has provided training for many employees of other companies.

However, there is no doubt that policy reforms are required to raise the FDI in Nepal but the implementation of these policies aren’t found effective and productive because there has been problem of inefficiency, poor transparency, poor responsibility and poor accountability in functioning of administration.

In the World Foreign Investment - 2005, the size of FDI inflow in Nepal has been very small as compared with India, Pakistan, Bangladesh and Sri Lanka. Many other factors are equally important for the successful entry of FDI. At the moment, human capital is weak because of limited skill, so, efforts should be made to train labor force to be more productive. The existing bureaucracy and organizational set-up should be improved for smooth implementation of government policies. In addition to it, some basic infrastructures like dry port, adequate power supply and transportation facilities have to be developed.

4.1.5 Institutional Arrangements

The Investment Promotion Board (IPB), chaired by the Ministry of Industry, Commerce and Supplies, is the primary government agency responsible for foreign investment. The expected functions of IPB are to coordinate policy level institutions, to establish guidelines for economic policies, to approve or disapprove foreign investment proposals, and to determine applicable investment incentives. The Department of Industry, under the Ministry of Industry, Commerce and Supplies, registers and classifies foreign investments. It also serves as the secretariat for the "One Window Committee," which manages the income tax and duty drawbacks granted to some foreign investments. The main functions of DOI are as follows:

1. Register medium and large scale industries.
2. Issue the industrial license.
3. Register and administer the Industrial property such as Patent Design and Trade mark.
4. Act as the secretariat of the Industrial Promotion Board (IPB) the highest body for industrialization of the country.
5. Act as the secretariat of One Window Committee for administration of various facilities such as tax holidays, duty drawbacks etc as provided by IEA.
6. Provide information to potential foreign investors and promote and issue the permission for foreign investment and technology transfer.
7. Prepare plans and programs and to carry out studies for the improvement and development of industrial sector.
8. Collect, maintain and publish industrial statistics.

9. Implement environmental impact assessment guideline and other environmental protection directives for monitoring industrial pollution.
10. Recommend for repatriation of dividends, sale of shares, principal and interest on foreign loan, royalty and fees for technical collaboration and part of salary and remuneration.
11. Recommend for non-tourist visa for carrying out studies for investment; business and residential visa for foreign investors and non-tourist visa and work permit for expatriates.
12. General and personal administration and accounting.

The Department has 11 sections manned by 79 personnel which includes 24 officers and 55 assistants.

4.2 Analysis of Secondary Data

This section analyses the various data relating to Foreign Direct Investment (FDI), which shows the year wise, status wise, sector wise, category wise, country wise and plan wise flow of foreign investment in Nepal. Table 4.1 shows the year wise flow of FDI in Nepal from the year 1980 to 1987 and table 4.2 shows the flow of FDI from the year 1988 to 2005. Year wise flow of FDI gives us the knowledge about the trend of foreign direct investment in Nepal from early 1980s to 2007. Table 4.3 shows the status wise flow of FDI in Nepal. Table 4.4 shows the flow of FDI in different sectors of the economy. Similarly, table 4.5 shows the category wise flow of FDI and table 4.6 shows the flow of FDI from different countries of the world. Lastly, table 4.7 shows the plan wise flow of FDI, which shows the flow of FDI in different plan periods, especially of the last three plans.

4.2.1 Year Wise Flow of Foreign Direct Investment in Nepal

Year wise flow of FDI from the year 1982 to 1989 is shown in table 4.1.The table-4.1 shows the year wise flow of FDI in Nepal from the year 1982 to 1989. The table shows only a modest rather fluctuating foreign investment both in terms of total fixed capital and authorized capital, although authorized capital is in no way an important indicator of investment. The total numbers of industries registered in the manufacturing sector between the years 1982-89 were 48, which involved the total fixed capital of Rs.1123.2 million and in the service, tourism and other sectors registered 26 industries, which involved the total fixed capital of Rs.808 million. The table shows that in 1983 there were only 4 industries under FDI in manufacturing sector which increased to 15 in 1989.

Thus, the table shows that the number of industries established under FDI was very insignificant during these periods. One of the main causes behind this slow increment might be the restrictive laws and policies adopted by the government. The policies were not investment friendly.

Table 4.1
Year Wise Flow of Foreign Direct Investment in Nepal (1982-1989)

	Manufacturing sector			Service, tourism and others		
	Total fixed capital (Rs in million)	No of industries	Authorized capital	Total fixed capital (Rs in million)	No of industries	Authorized capital
1982	Na*	Na	Na	2	1	2.4
1983	196.8	4	246.1	Na	Na	Na
1984	88.0	4	133.1	29.6	4	43
1985	10.2	3	19.0	6.2	2	10
1986	532.0	12	775.6	9.7	4	20.6
1987	176	7	463.5	12.5	3	18
1988	91.2	3	139.5	12	3	19.4
1989	29.0	15	354.3	355.8	9	694.6
Total	1123.2	48	2131.1	427.8	26	808.0

**Not available, Department of Industry Nepal Government, 2008*.

In the subsequent period of 1980s Nepalese economy was suffering from various macro economic crisis like increasing negative balance of payment, high rate of inflation, growth of debt burden, budget deficit etc, due to which it was difficult to attract FDI in Nepal. Along with this the other causes which were responsible for the slow flow of FDI were the shortage of electricity in that period from which Nepal was suffering, which is very essential for establishing industries and for attracting FDI into the country. Besides this, the country was suffering from poor infrastructural facilities like roads, communication etc. Roads are the backbone for market extension and the necessary condition for economic activities. Lack of adequate transportation system would raise the cost of production thereby eroding competitiveness in the international market. The same period also witnessed inadequate and inefficient communication facilities. So, all these causes were responsible for the low FDI during these periods.

The year wise flow of Foreign Direct Investment (FDI) in Nepal from the year 1990 to 2007 is shown in table 4.2. During the period 1990 to 2007, the total number of foreign investment projects in Nepal marked 935. Up to January 2007, the total project cost leveled Rs.88904.27 million. The total fixed cost was Rs.74014.69 million during the same period. FDI was equal to Rs.466.84 million in 1988/89, which increased to Rs.1793.77 million in 2004/05. The contribution of FDI was as high as Rs.1209.95 million in 2002/03, which significantly increased to Rs.2755.40 million in 2005/06 and again decreased to Rs.311.08 million in 2006/07.

The size of FDI was confined to Rs.1209.95 million in 2001/02. During the last twelve years between 1990/91 to 2004/05 trends in FDI were found to be erratic, jumping from Rs.466.8 million in 1990/91 to Rs.3083.67 million in 1994/95, and for the next two consecutive years it declined. And then in 1997/98 it started to increase and this trend lasted only for two years. Again FDI continued to decline for three consecutive periods between 1999/2000 to 2001/2002. Take off in FDI was further visualized in 2002/03. However, FDI has decelerating trend in recent years that confined to Rs.311.08 million in 2006/07.

Table 4.2
Year Wise Flow of Foreign Direct Investment in Nepal (1990-2007)

(Rs. in million)

Fiscal Year	Number	Total Project Cost	Total Fixed cost	Foreign Investment	Employment
1990/91	60	5440	4595.51	466.84	10604
1991/92	30	2438.19	2139.60	398.51	9515
1992/93	23	863.56	690.74	406.28	2,974
1993/94	38	3508.17	2902.10	597.84	5615
1994/95	64	17886.22	16,210.81	3083.67	13873
1995/96	38	3733.23	3175.66	1378.76	4734
1996/97	19	1927.28	1247.85	477.59	2386
1997/98	47	10,047.47	9398.54	2219.86	8032
1998/99	77	8559.25	6692.15	2395.54	9347
1999/00	77	5569.38	5142.32	2000.28	4336
2000/01	50	5234.42	4380.17	1666.42	2146
2001/02	71	2669.09	1910.24	1417.61	4703
2002/03	96	7917.62	6122.49	3102.56	6880
2003/04	77	3310.53	1550.89	1209.95	3731
2004/05	74	4921.82	3608.25	17,93.77	3572
2005/06	77	4309.65	3762.17	2755.40	2144
2006/07	17	770.39	476.52	311.08	3432
Total	935	88904.27	74014.69	25681.66	98024

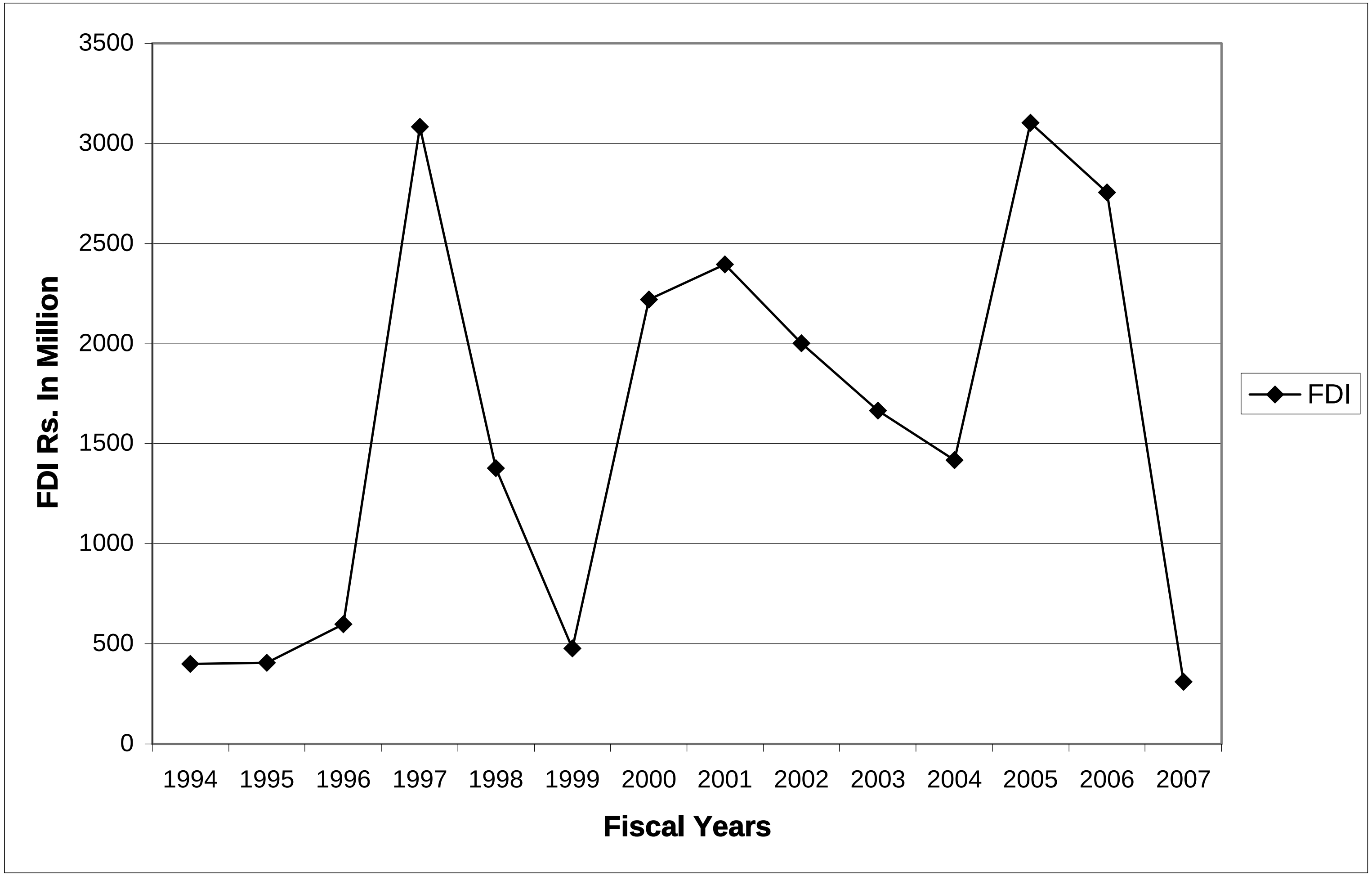
Source: Department of Industry Nepal Government, 2008.

Thus, from above table we can conclude that the flow of FDI projects in the beginning of 1990s was encouraging. The main cause behind this was the incorporation of various facilities in the Foreign Investment and Technology Transfer Act (FITTA-92), and Industrial Enterprise Act (IEA-92), which were not in existence prior to 1992. In these acts various facilities like, repatriation facilities, visa facilities, various tax incentives, convertible foreign exchange facilities, land facilities were offered to foreign investors and hence foreign investors have shown interest in investing in Nepal in the early 1990s.

Pursuant to section 5(2) of FITTA, a foreign investor making an investment in foreign currency is entitled to repatriate the amount out side the kingdom of Nepal at the prevailing rate of exchange. Security of investment is one of the most important matters in relation to foreign investment. Section 21 of the IEA 1992 made a clear provision on non-nationalization of industries whether the Nepalese or foreign investors establish them. However, the FITTA-92 has adopted two mechanisms: mutual consultancy in the presence of department and arbitration. If disputes could not be settled down by mutual consultation then the dispute can be settled down by arbitration in accordance with the prevailing arbitration rules of the United Nations Commission on International Trade Law (UNITRAL). Along with this a foreign investor and his dependent who at a time, makes investment in an amount no less than US$100 thousand or equipment will be granted a residential visa as long as the investment is retained.

Figure 4.1

Year Wise Flow of FDI



These policies have also included that there was no royalty on captive power generation for industry's own use and no double sales tax on the import of raw materials and products. Thus, these various facilities which were provided to the foreign investors were much liberal than the previous ones and helped a lot to attract FDI into Nepal. One window policy was also introduced to improve efficiency and productivity of administration for attracting FDI. Thus, in the first half of 1990s, there was encouraging flow of FDI. During this period various infrastructural facilities like power, road, communication and aviation were also developed to some extent. Thus, favorable political economy and policy reforms were the primary causes of the growth of FDI projects during the first half of 1990s. But after mid 1990s, due to Maoist insurgency and insecurity in the country, the FDI began to decrease. Maoists have particularly attacked the industries having foreign investment, such as Colgate Palmolive Limited, Nepal Lever Limited, Asian Paints, Surya Tobacco Company etc. Their ruthless attacks have made the investment distracted both from domestic and foreign investors during that period. Along with this, political instability in the country was also responsible for low foreign investment particularly in those years.

Year wise flow of FDI is also plotted in figure-4.1. It shows the investment flow as per the record of Department of Industries (DOI) from 1992 to 2007. According to the data of DOI records, the highest foreign investment flow after 1990 was found in 2002/03 (Rs 3102.56 million), followed by Rs 3083.67 million in 1994/95. After 2001, FDI again reduced to Rs 1206.95 million in 2004, after that it raised to Rs.1406.79 million in 2005 and once again it started to reduce in the fiscal year 2006/07 to Rs 311.08 million. Thus, this figure also shows the fluctuating trend of FDI in different years, main causes of which were the inefficient enforcement of laws and policies, Maoist insurgency and political instability in the country. Thus, for smooth flow of FDI, the environment of the country must be made favorable. There must be security of investment and the laws and policies should be enforced efficiently.

4.2.2 Status Wise Flow of Foreign Direct Investment in Nepal

Table 4.3 exhibits the status wise flow of foreign direct investment in Nepal. It shows that the number of joint ventures in Nepal marked 935 as of January; 2007. The data reflects that the size of total investment was Rs.88904.27 million till 2007, while the total fixed capital marked Rs.74014.69 million. Up to 2007, total FDI accounts for Rs.25681.66 million. The total number of industries which are operational are 401 as per January 2007.

Table 4.3
Status Wise Flow of Foreign Direct Investment in Nepal (1990-2007)

(Rs.in million)

Status of industries	Number	Total project cost	Total fixed cost	FDI	Employment
Operational	401	47062.28	39836.57	10892.86	50176
Under construction	33	5373.74	4866.24	1260.97	4303
Licensed	122	13040.53	10388.09	3838.58	15114
Approval	286	13348.05	10213.68	6966.50	17313
Closed	21	1570.46	1329.68	442.67	1924
Cancelled	72	8509.20	7380.43	2280.09	9194
Total	935	88904.27	74014.69	25681.66	98024

Source: Department of Industry Nepal Government, 2008.

Similarly, the numbers of industries which are under construction are 33 and the number of industries which are licensed are 122. The numbers of approved industries are 286 till 15th Jan, 2007. 21 industries are closed and 72 industries are cancelled till the date. The size of FDI was 5.3 percent of GDP and 22.1 percent of budget for FY 2005/06.

The ratio of operating category joint venture industries was 42.8 percent of the total, followed by under construction category 3.53 percent, under licensed category 13.05 percent, under approved category 30.59 percent, under closed category 2.25 percent and under cancelled category 7.7 percent. The total fixed capital under operating category was Rs.39836.57 million and total FDI was equal to Rs.3838.528 million. The ratio of FDI under operating category was 42.4 percent, under construction category 4.9 percent, under licensed category 14.9 percent, under approved category 27 percent, under closed and cancelled category 1.7 percent of the total FDI. The data shows that FDI has provided employment to 98024 people, which is approximately 0.9 percent of the economically active population. Employment provided through FDI under operating category was around 51 percent, followed by under construction category 4.3 percent, under licensed category 15.4 percent and approved category 17.6 percent.

However, number of industries in the closed category has increased mainly because of the rising security threat. Foreign investors are facing rising security threat reportedly from the Maoist insurgents. In the last few years many multinationals have been attacked. Few years back, Colgate Palmolive Limited was attacked by Maoist and they blasted the main plant of the factory, which was under-operation at that time. The explosion caused damaged of over 80 million rupees resulting in the closure of the factory and leaving the workers unemployed. Similarly, another group of miscreants set fire to the two main godowns of Surya Tobacco Limited causing a loss of over 10 million rupees. Less powerful bombs exploded in Nepal Lever Limited and Asian Paints, two major joint ventures operating in Nepal some year back, which caused minor losses. Attacks on joint venture industries and business houses, especially Indians have further complained about the worsening security situation. Since India is the largest foreign investor, such investment unfriendly acts would not only discourage future investment but also force the existing joint ventures to leave the country. Besides this, a number of reports on forced monetary donations targeting joint ventures are another threat to discourage foreign investment in Nepal.

Thus, the status wise flow of FDI helps us to know about the number of projects which are operating, under construction, licensed and it helps to know about the number of projects which are closed or cancelled.

4.2.3 Sector Wise Flow of Foreign Direct Investment in Nepal

Table 4.4 shows the sector wise flow of FDI in Nepal. This table indicates that FDI has flowed mainly into the manufacturing units. However, manufacturing sector includes industries relating to medicine, packaging materials, diesel pump sets, television/telephone, plastic tank, silk and polyester, readymade garments, suiting/shirting/saree, residential and commercial complex, paints, white sugar, dairy products, mineral water, hair oil, tooth powder/tooth paste, cement, laminated tubes, iron rods, bakeries, leather shoes and leather tanning, fertilizers, soap, biscuits and confectionary, dry cell battery, lubricating oil, menthol crystal, refractory bricks, cotton/synthetic textile, electrical bulbs, cigarette, copper utensils, copper enamel wire, tyre-retreating, and ice cream etc. Manufacturing sector has succeeded to attract FDI to the level of Rs.9033.48 million, which is 38.9 percent of total FDI. The flow of FDI is highest into the manufacturing sector, which is mainly because the goods produced in this sector are consumed in the market easily and also gets relatively easy access to the international market. The goods which are easily sold in the market attract more FDI. Along with this, availability of cheap labor cost has also attracted FDI in this sector.

Table 4.4
Sector Wise Flow of Foreign Direct Investment in Nepal (1990-2007)

(Rs.in million)

Types of Industries	Number	Total project cost	Total Fixed Cost	Foreign Investment	Employment
Agriculture & forestry	13	1670.05	1511.27	454.19	813
Manufacturing	440	35554.35	25997.37	10000.72	60619
Food, beverage & tobacco	73	9171.99	7962.49	2198.92	9084
Textile, tea and garment	148	8465.27	5341.88	2940.43	32873
Wood & wood product	8	116.36	89.85	41.52	1440
Paper & paper product	21	1796.98	1527.43	318.90	892
Chemical & plastic product	79	6368.40	4722.27	1969.27	6563
Non-metal mineral product	17	3567.26	2157.47	869.16	2928
Basic metal product	24	2169.98	1434.62	670.50	1907
Fabric metal, m/c	51	3042.41	2146.75	795.64	3568
Other manufacturing units	19	855.75	614.62	196.38	1364
Electricity, water, gas	19	19686.77	17969.09	3299.56	4950
Construction	29	1578.99	1253.85	998.83	1716
Hotel & resort	227	15706.28	14907.60	4474.21	14585
Transport & communication	25	4095.70	2818.55	1618.96	5039
Hotel & apartments	17	256.43	105.21	145.51	1509
Service industries	165	10355.70	9451.75	4689.69	8763
Total	935	88904.27	74014.69	25681.66	98024

Source: Department of Industries Nepal Government, 2008.

Similarly, the major items under tourism, services, agro-based and construction categories include printing press and advertisement service, LPG gas refilling, computer training, auto workshop, hotel service, animal feeds, tea garden, and processing, restaurant, cargo service, educational-medical, marketing service, transport service and computer parts. Flow of FDI in the hotel and resorts can be considered reasonably good because Nepal is blessed by nature with her gorgeous flora and fauna, lakes, rivers and mountains which has attracted investors for investing mainly in Hotel and resorts. Tourists from various parts of the globe visit Nepal. Tourists can enjoy rafting and trekking in this country. High altitude research is also done here. Thus, many investors have shown their interest to invest in this sector.

In the context of FDI, service industries that accounts for Rs.3299.56 million, which is 18.26 percent of the total FDI have occupied second position. Hotel and resorts which accounts for Rs.4474.21million, which is 17.42 percent of the total FDI are placed in third position with respect to the flow of FDI. The total fixed cost in the manufacturing sector is Rs.25997.37 million, while in electricity, water, gas it is Rs.17969.09 million and in hotel and resort it is Rs.4474.21 million.

The highest number of employment (60619) is provided by manufacturing sector, which provides 61.8 percent of the total employment, followed by textile, tea and garment industries (32873), which are 33.5 percent of the total, hotel and resort industries provide employment to 14.8 percent of the total which come next in this regard.

4.2.4 Category Wise Flow of Foreign Direct Investment in Nepal

Table 4.5 shows the category wise flow of FDI in Nepal. Broadly, FDI industries are categorized into seven sectors which include agriculture, manufacturing, tourism, service, construction, energy-based, and mineral based. Table 4.5 is illustrated and constructed as per the record obtained from foreign investment promotion center established under DOI. This table shows that the number of industries in the agriculture sector was 14, the number of industries in the manufacturing sector was 404, in tourism it was 191, in service it was 173 while in construction, energy based, mineral based industries it was 13, 14 and 3 respectively.

This table reveals that the manufacturing industries constitute the highest position in terms of number of industries, total project costs, fixed investment, foreign investment, and employment generation. A look at the table 5 above reveals that manufacturing industry commanded approximately 42% of the total foreign investment inflow, 49% of the number of industries, 36% of the fixed investment and 41% of the total project cost. The industries of this sector alone constitute 63% of the total employment generated by FDI industries till 2003.

Service sector industry has constituted the second position in terms of foreign investment flow with the percentage of 21.66 against 19.66 % of tourism industry, which has out run the service industry, in other remaining heads such as in number of industries by 23.52 % against 21.3 % and in employment generation by 15% against 11.9 % and hence tourism industry has occupied second position in almost every aspect. Thus this figure has given us the knowledge that till now manufacturing sector has been able to obtain the highest number of FDI, the causes for this are already mentioned above.

4.2.5 Country Wise Flow of Foreign Direct Investment in Nepal

The table 4.6 shows the country wise flow of FDI in Nepal. In total, investors from forty eight different countries have invested in Nepal but the scale and number of projects in most cases is very small. FDI is reasonably concentrated with seven countries accounting over four-fifth of cumulative FDI. India alone accounted for one-third of FDI, followed by United States and then China. The table shows that the number of Indian joint venture projects is highest in Nepal (295), which is 31.5% of the total projects. China comes next after India, which has 95 joint venture projects in Nepal which is 10.16 % of the total. Japan is in 3rd position which has 88 joint venture projects in Nepal, which is 9.15 percent of the total.

Table 4.5

Category Wise Flow of Foreign Direct Investment in Nepal (1990-2007)

(Rs.in million)

SN	Types of Industries	No of Ind.	%of Ind.	Total project cost	% of project cost	Total Fixed investment	% of fixed investment	Foreign Investment	% of foreign investment	Employment	% of employment
1	Agriculture	14	1.7241	428.15	0.51442	375.2	0.5412	94.38	0.4246	986	1.077
2	Manufacturing	404	49.753	34319	41.2341	25101.5	36.205	9300.9	41.839	58410	63.83
3	Tourism	191	23.522	15664.1	18.8204	14902.4	21.495	4371.9	19.667	14159	15.47
4	Service	173	21.305	12178	14.6318	10162.3	14.658	4815.6	21.662	10896	11.90
5	Construction	13	1.6009	769.29	0.92429	621.49	0.8964	396.64	1.7842	1165	1.273
6	Energybased	14	1.7241	18717.9	22.4894	17100.1	24.664	3204.7	14.416	4759	5.200
7	Mineralbased	3	0.3694	1153.14	1.38549	1068.32	1.5409	45.98	0.2068	1129	1.233
8	Total	812	100	83229.6	100	69331.5	100	22230	100	91504	100

Source: Summary Sheet of Department of Industry, 2008.

Figure 4.2

Category Wise Flow of FDI

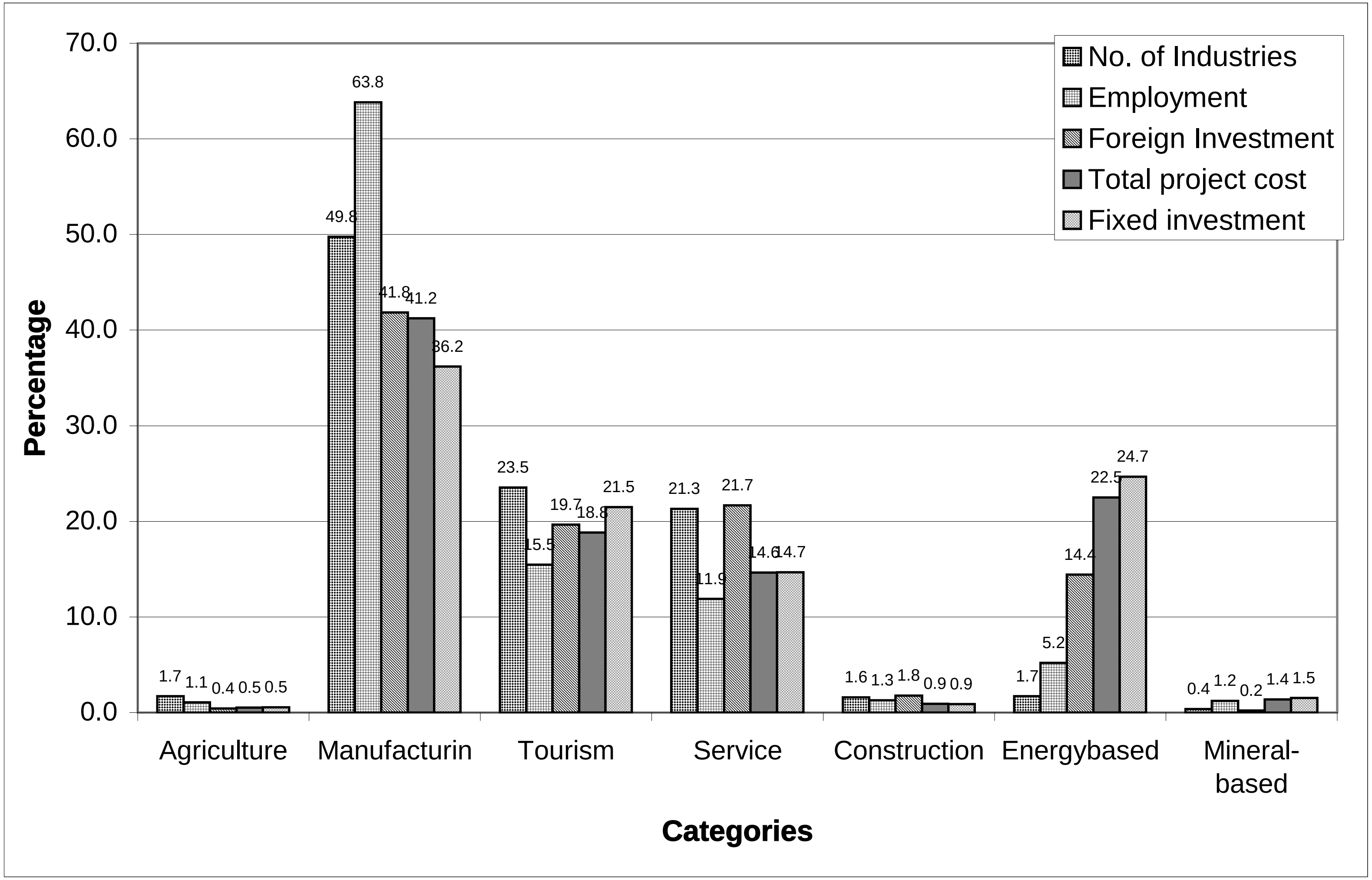


Table 4.6
Country Wise Flow of Foreign Direct Investment in Nepal (1990-2007)

(Rs. in million)

Country	No	Total Project Cost	Total Fixed Cost	Foreign Investment	Employment
Australia	9	141.59	108.82	90.50	359
Austria	9	171.06	130.71	46.36	350
Bangladesh	12	446.14	206.89	211.70	3401
Belgium	1	7.00	5.98	5.95	30
Bermuda	6	1995.25	1694.03	118.27	1474
Bhutan	3	27.26	20.58	3.61	98
Brazil	2	21.07	7.50	4.43	221
Bri. Virgin Island	4	3439.78	3301.19	1282.94	1210
Canada	9	723.48	630.91	576.30	1289
China	95	9094.25	7610.45	2717.24	7751
Denmark	4	521.92	467.18	30.14	236
England	3	15.53	14.20	11.04	Na
Finland	2	10.00	6.86	4.55	91
France	23	439.36	373.44	109.20	1069
Germany	40	1703.88	1557.77	568.14	2657
Ghana	1	6.50	6.18	1.95	Na
Guatemala	1	10.00	5.00	2.50	84
Hong Kong	15	1343.54	1099.44	525.24	2075
India	295	31721.73	24455.53	9752.46	40592
Iran	1	5.00	1.80	1.00	Na
Ireland	1	5.00	1.00	1.5	40
Israel	3	605.60	504.38	73.50	82
Italy	14	1239.90	1124.40	190	329
Japan	88	2809.20	2421.26	925.23	5247
Malaysia	6	43.65	33.07	22.08	188
N. Korea	1	44.82	41.20	12.55	71
Netherlands	9	1062.65	892.28	409.94	2052
New Zealand	7	283.63	228.66	17.07	1994
Norway	7	8035.59	6692.40	1061.33	538
Pakistan	11	310.34	223.97	132.47	2331
Panama	1	83.28	65.17	24.98	121
Philippines	4	934.18	859.53	50.35	1354
Poland	2	89.72	85.55	7.39	39
Russia	4	90.55	59.93	38.73	191
S. Africa	2	30.00	24.84	30.00	59
S. Korea	37	1701.94	1424.52	876.76	2942
Singapore	9	1603.57	1547.07	332.04	1155
Slovenia	1	4.19	3.94	4.19	Na
Spain	3	23.72	20.26	18.97	25
Sri Lanka	3	79.15	55.90	37.41	83

Switzerland	18	513.90	441.86	135.88	324
Taiwan	6	337.64	304.00	143.37	571
Thailand	7	950.12	810.68	90.64	1106
Turkey	1	5.00	3.00	17.50	35
UAE	1	178.54	37.24	45.00	93
UK	27	1888.40	1625.09	166.61	5240
USA	84	12,629.68	11,496.67	4018.18	7810
Ukraine	1	90.00	82.00	14.70	18
Total	935	88904.27	74014.69	25681.66	98024

Source: Department of Industries Nepal Government, 2008.

USA has 84 joint venture projects which is 8.98 % of the total. The factor intensity of investment tends to reflect each home country's comparative advantage: comparing the share in FDI with share in employment, Indian investments are most labor intensive and while Norway and the United States are most capital intensive. The magnitude of FDI from India was Rs.9752.46 million, which was 37.97 % of the total. The size of FDI from major countries such as the USA marked Rs.4091.45 million which was 15.65 % of the total, followed by China Rs 2717.24 million, which was 10.58 % of the total and Japan Rs.925.23 million, which was 3.60 % of the total. Indian joint ventures provided the highest employment (40592), which was 41.4 % of the total employment, while other countries which provided employment to large number of people were the USA (8579), China (7751), Japan (5349), UK (5254), Bangladesh (3401), and South Korea (2975).

Thus, through this table we can conclude that India has been the country from which Nepal is obtaining the largest number of FDI. India has been the major investing country in Nepal; proximity factor is attributed to attract FDI from India as compared to other countries. In addition, Nepal and India share common heritage from the time immemorial, which has played a critical role in determining more FDI from India. Besides this, Nepal and India enjoy a special trading relationship and the Trade treaty signed for on December 5, 1996, which lays the foundation for an open trade relationship based on the spirit of mutual benefit. One of the central feature of the treaty is that it provides duty-free access to Nepali manufactured goods giving them equal footing in the Indian Market with Indian goods.

Nepal has also signed bilateral investment treaties with India, Britain, Germany and Norway. Nepal is also a member for the Multi-lateral Investment Guarantee Agency (MIGA), which it joined in 1993. MIGA provides guarantee to foreign investors against non-commercial risks like currency transfer, expropriation and breach of contract, war and civil disturbance in the host country. Agreement avoiding double taxation on the dividend and return on FDI has been reached with a number of countries including Thailand, India, China, Austria, Republic of Korea, Mauritius, Pakistan and Sri Lanka. All these have attracted FDI from different countries of the world.

4.2.6 Plan Wise Flow of Foreign Direct Investment in Nepal

Table 4.7
Plan Wise Flow of Foreign Direct Investment in Nepal

(Rs. in million)

Plan	No. of projects		Total capital Investment		Total foreign Investment		Total employment	
	No.	%	No.	%	No.	%	No.	%
Before eighth five year plan	150	16.18	12235.84	13.77	186.47	0.72	2890	2.95
Eighth five year plan	245	26.42	41853.45	47.11	9555.42	37.28	38372	39.21
Ninth five year plan	373	40.24	24805.79	27.92	9432.2	36.7	21796	22.27
Tenth five year plan (up to 2062)	159	17.16	9947.67	11.20	6485.62	25.30	34793	35.58
Total	927	100	88842.64	100	25630.73	100	97851	100

Source: National Planning Commission Nepal.

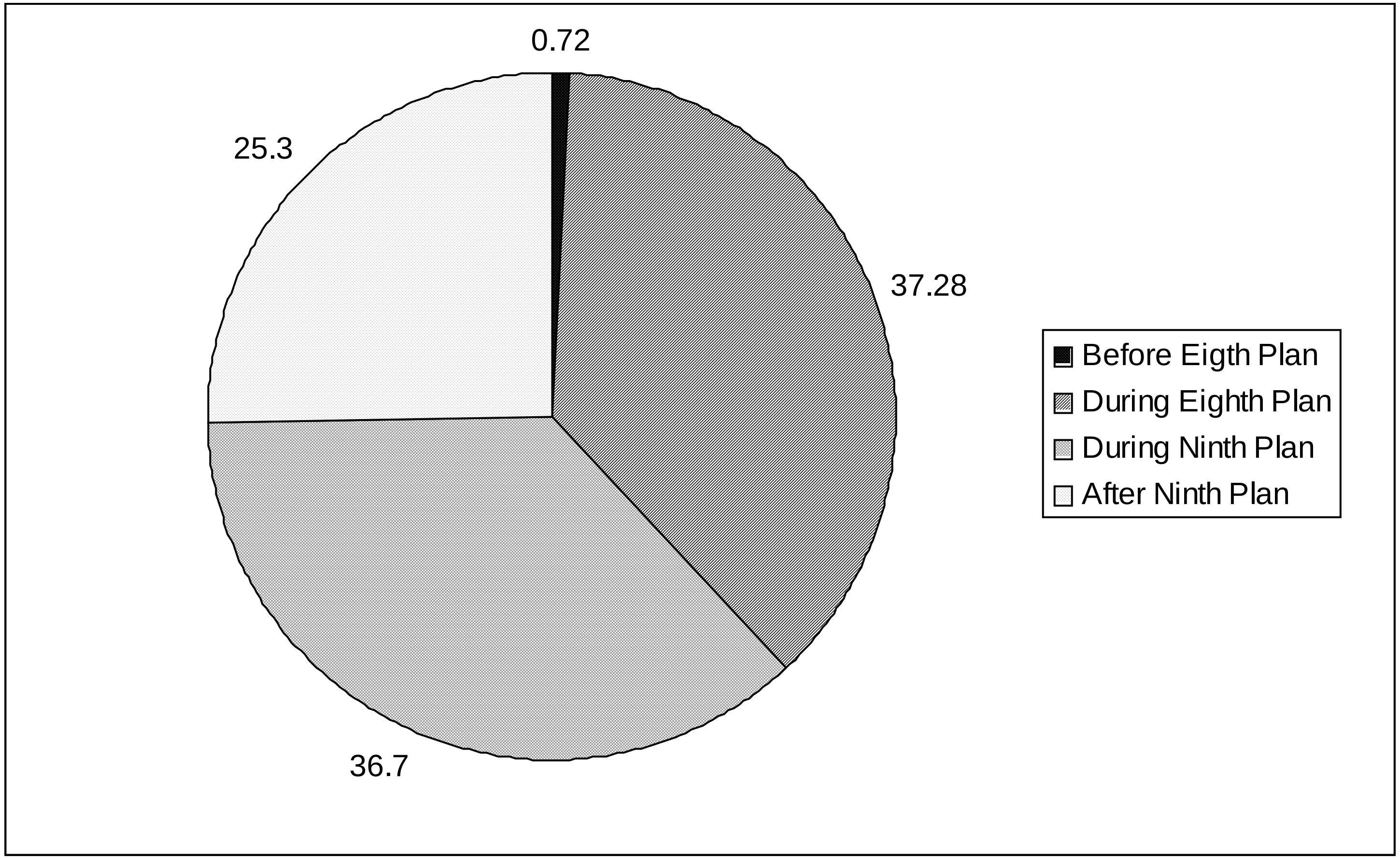
Table 4.7 shows the plan wise trend of FDI in Nepal especially of the last three plan periods. The table shows that before eighth plan, 150 foreign collaborated projects were registered with the total capital investment of Rs.12235.84 million. The eighth plan had 245 projects with the capital investment of Rs.41853.45 million and the foreign investment Rs.9555.42 million. In the ninth plan period, 373 new projects with capital investment of Rs.24805.79 million and the foreign investment of Rs.9403.22 million were approved. Similarly, in the first two years of the tenth plan 159 new projects were registered with capital investment of Rs.9947.67 million and the foreign investment of Rs.6485.62 million.

From above analysis, what we infer is the intensity of foreign direct investment in terms of either capital investment or foreign investment or employment generation is concentrated in the eighth plan period except in number of industries in the ninth plan. This indicates that political stability; national consensus and maintenance of peace and security are the foremost preconditions for the foreign direct investment to flow in any country.

Plan wise trend of FDI is also shown in figure- 3. This figure shows that the flow of FDI was highest during eighth plan (37.28 %) period which was mainly due to the peace and security and political stability in the country. While during the ninth plan it was 36.7 %. Ninth plan has given emphasis for the development of private sector, as private sector development is the key factor for the development of mainly industrial and service sectors. Although significant progress has been made in this area during 1990s as a result of liberal and market-oriented policies adopted by the government, the progress has been constrained by a number of factors. Private investment in Nepal remains low and FDI is the lowest in the region. Political instability and conflict have eroded business confidence, but there are still numerous impediments to private sector development. Among other things, bureaucratic delays in the provision of government services, lack of clarity of laws and policies, excessive documentation requirements and non-implementation of the policies are some of the problems identified by the private sector as the constraints for making private sector more vibrant and dynamic.

Figure 4.3

Plan Wise Flow of FDI



Although there were some problems, significant improvement has been made in major infrastructures (roads, electricity and telecommunication), but the road density, penetration of telephone and public access to electricity are still low. Maintenance of major roads and highways is a crucial problem. Fifteen district headquarters have not yet been connected by road. Involvement of Village Development Committees (VDCs) and District Development Committees (DDCs) in rural road construction has been very impressive, but the quality of construction has yet to be improved. Telephone distribution is only about 14 percent, and the share of population with access to electricity is about 40 percent. Significant involvement of the private sector has also seen in the hydropower sector. Similar progress has also been made in opening up the communication sector.

The flow of FDI during the first two years of the tenth plan was 25.3%. The tenth five year plan has set poverty alleviation as sole objective to achieve the target of 32 percent. To achieve the objective, the plan has adopted broad-based economic growth strategy through industrial development and investment promotion. As the mid-term evaluation of Ninth Five Years Plan has identified some problems related to foreign investment that comprises relatively small domestic market, limited capital resources and infrastructure, administrative hurdle and harassment, slow administrative decision making, lack of skilled man power, lack of security and promotional program, the tenth plan sets strategies and policies particularly addressing these problems. Though it tried to solve some of the problems faced by the ninth plan, tenth plan also has to face some problems. The prolonged conflict has remained as the biggest threat to the successful implementation of the tenth plan. The conflict, which started in 1996, has taken lives of several thousand people and destruction of infrastructure has cost more than a quarter of a billion dollar. Implementation has been a big challenge during conflict. Infrastructure development activities as well as service delivery especially in the conflict-affected areas have deteriorated due to increasing intensity of the conflict. However, the successful implementation of programs, policies and projects depend on the institutionalization of the implementation mechanism. Frequent changes of the Government (especially Ministers and Planning Commission) and frequent transfers of the secretaries weaken the institutionalization process.

However, there is preponderance of joint ventures despite the fact that100 % equity ownership by foreign investors is allowed in almost all sectors (except for a short negative list). Fewer than 36 of the 350 firms are wholly foreign owned. Most of these 36 firms are relatively small, but they include seven of the nine firms with capital exceeding $ 1 million (Investment Policy Review: 2003). The preponderance of joint ventures may be seen as an effort by the foreign investors to minimize non-commercial risks by taking on local partners.

Despite the various policy measures, Nepal's receipt of FDI remained low, compared for example with the Lao Peoples' Democratic Republic (PDR) and Mongolia. No countries are entirely alike, but Lao PDR and Mongolia are useful comparators given that they share the feature of being land locked in Asia. The Lao PDR is endowed with water resources, as in Nepal; the former possesses some mining and petroleum resources, but this sector accounts for less than one-fifth of FDI in that country. Mongolia has received considerable FDI in gold mining. Nepal does not fare well in attracting FDI compared to even Lao PDR and Mongolia, though Nepal's Market size is larger and GDP is higher. After the revision of law on investment and taxation, these two countries have been quite successful in attracting FDI. Nepal should also create more hospitable environment to attract foreign investment.

Asia and Pacific region is the largest recipient of FDI in the world in 2005/06. The top 3 countries were headed by China, Hong Kong (China), Singapore. China alone attracted more than $ 50 billion. This is mainly due to the investment from Non–Resident Chinese migrated during the Cultural Revolution in China. India and South Korea attracted more than $ 4 billion each. Among the sub-region, ASEAN attracted most which is around $19 billion. This is mainly due to their improved economic conditions and better investment climate. South Asia received around $ 6.2 billion in FDI in 2005. India is the dominant host country for FDI inflow. Except Maldives and Bhutan, FDI flows to other SAARC countries include Sri Lanka, Pakistan, Bangladesh and lastly Nepal. Bangladesh, a much larger country, experienced a major acceleration of FDI inflows during the second half of the 90s, but is also due to Nepal's inability to sustain the momentum of its flows of 1996-97.

4.3 Prospects of Foreign Direct Investment in Nepal

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 generations through which the country's twin objectives of poverty alleviation and generating higher rate of growth could be attained. In the verge of the globalization, 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 our colossal but unexploited sectors are brought optimally into use. These sectors because of our low public investment capacities and traditional mode of technique lay unused as they simultaneously require large amount of fund and modern machines and machineries and as such must be rendered to foreign investors, firms or corporations to operate either singly or in joint ventures with domestic firms so that they could be exploited into desired extent to overcome the country's supply side bottlenecks. The feasible project areas in which foreign investment is cherished to flow are as follows.

Agro and Forest Based Industries

Nepal is rich in bio- diversity. She encompasses diverse topographical structure, multitude soil variety and varied climatic environment because of which various biotic and non-biotic beings 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.

Medicinal and Aromatic Plant

Despite the huge possibility of producing and processing required drugs and cosmetics within the national territory, Nepal is forced to import these materials around seven percentage of GDP per year. 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 far various purposes, encouraged to put into commercial use since the establishment of Royal Drugs Research Laboratory in 1962. Till now only 300 species have been screened arid studied. Recently it has been considered important to commence commercial plantations or medicinal plants such as atropa belladonna and aromatic plants such as palmarosa, lemon grass, Citronella, and menthe arveniss. The Department of Industry (DOI) manual points out the good prospects for the cultivations and processing of chrysanthemum cinerariaefolium (pyrethruin), claviers purpurea (ergot), digitalis lanata, eucalyptus camaldulensis, glvcvrrhizin flabra, mucuna pruriens, piper longum and valeriana wallichi (Investment opportunities in Nepal-manual published by DOI).

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.

Vegetable and vegetable Seed Production

A wide variation in agro climatic regions from tropical to temperate and alpine climates provides opportunities to produce vegetable and vegetable seeds of a wide range of varieties. More importantly, the pockets of microclimates separated by high mountains provide ideal environment where the risk of loosing parental lines of high value seeds is minimal. Nepal has fifteen main centers for vegetable seed production among which four of them namely Musikot, Kathmandu, Sarlahi and Thak Khola Marpha lying in the Mid-eastern, Central and Western development regions respectively are found highly successful in the production of a variety of seeds. To promote vegetable and vegetable seed production the government has established the vegetable development division in the Department of Agriculture, which is assigned to provide technical, and equality control services.

These facts indicate the good potentialities for establishing the vegetable seed farms in Nepal catering to the needs of both domestic and foreign markets. The investment in this sector from foreign investors would assist to link the Nepalese seed production market with the markets of India, Bangladesh, Sri Lanka, Pakistan and Thailand where the seed quality standards resemble with Nepalese standards. It is possible to tap the export markets in European and American countries with the participation of investors from these countries.

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

Fruit Processing

Bestowed with good ecological conditions, Nepal enjoys high opportunities for the cultivations of variety of fruits such as apple, banana, pineapple, mango, orange, grapes, pear, litchi, guava, 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. Recently apple export to Bangladesh has been initiated.

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, advanced technology and market networks and thus this sector also keeps good prospects for foreign investor to focus their investment on.

Tea Development

The tea production in Nepal commenced at recent time and as such it is passing through the infancy stage of development. The availability of institutions in relation to its promotion and the number of industrial units established for tea production and processing reveals the poor state of tea business in Nepal in spite of its enormous potentiality resulted due to the geographical features, multitude soils variety and the variety in climates As PCI- DOI manual, The Nepal Tea Development Corporation, a government agency, owns seven tea gardens with a total area of around 880 hectares. In addition, the private sector owns tea gardens with a total area of around 1250 hectares. These tea-growing areas are in the eastern districts of I1am, Jhapa, Pachthar, Terhathum and Dhankutta, almost adjacent to the world-renowned tea gardens of Darjeeling in India.

The government has given 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-how and efficient management systems are required to bring the tea industry in line with other tea producing countries in the region.

Sericulture

Experts from Japan, Korea, China and India have identified the development of sericulture as offering very good prospects for development in the mid-hills and Terai belt of Nepal. Agro climatic conditions in these areas favor the cultivation of mulberry and the rearing of cocoons. For sericulture development, the Government has set up a nucleus center at Khopasi (Kabhre Planchwok district) about 35 km. east of Kathmandu since 1975. Initially the center functioned as a demonstration center. However, later on it extended its function in the areas of training and research with a major function as a silkworm egg breeding station since 1991/92. Nepal has developed six bivoltine lines and these will be used to produce hybrid silkworm eggs in the country. The preferred production technology in Nepal is the temperate bivoltine technology that is simple and easily adaptable by small farmers.

Studies show that the mulberry cultivation could be extended over an extent of 6000 hectares that could yield around 350 tones of raw silk. The value of silk fabric from this level of production could exceed Rs. 1800 million, However, the widening and deepening of the programme has come to halt due to the lack of fund and fond as most of the people lay unknown about its business potentiality and profitability due to poor state of business facilitation measures. For linking the silk production in Nepal with international markets, Private foreign investment must be encouraged for Post cocoon activities involving reeling, twisting, weaving and production of items out of silk fabric. It would also produce backward linkage by encouraging mulberry cultivation and cocoon rearing by small farmers.

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. She 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 well suited to dairy development. An integrated dairy industry incorporating related activities such as improved livestock breeding, cattle teed 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.

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 1992 to Rs 13124.7 million in 2004. USA's preferential facility under MFA has contributed for better performance. After the phase out of such facility, 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 resource 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.

Carpet Industries

Nepal's second most position in the export front is occupied by carpet industries, which is persistently on the rise with the export value of Rs 231875 million in 1992 to Rs 859217.3 million in 2004. This industry, which is heavily concentrated in the European markets possesses good potentiality of earning foreign exchange if produced in 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 labor in the carpet weaving has degenerated the international credit of this industry. To gain the international credit and produce in low cost, attempts are to be made to avoid child labor and adulteration of lower quality threads by employing advanced tools and technique, efficient management mechanisms and skilled manpower. With foreign collaboration, the competitive edge of this industry in international market can easily be gamed as we have lower wage rate and low setting cost of plants.

Hydropower

Nepal's theoretical power potentiality is assumed to be 83000 MW out of which the exploitable capacity is believed to be 42000 MW. Till now only 0.5 percent is exploited. The slow process of power generation in Nepal is that it requires the investment in high amount exceeding the capacity of national budget. 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 the lack of advanced technology and technical know-how.

Government has recently formulated the hydro policies with an eye to matching the private sectors' need so as to involve them in this sub-sector development. With the pursuance of privatization and liberalization policies, involvement from private sector has commenced to generate hydropower. To intensify the power generation there is a high need of collaborating domestic investors with the foreign investors

Tourism Industry

Tourism industry has importantly contributed to Nepalese economy in the matter of earning foreign exchange and generating income and employment. The government has accorded high priority to the development and expansion of tourism industry and to that extent a good attempt has been made to environmental and infrastructural development to strengthen the industry.

The outgoing violent Maoist insurgency had lessened the dynamism of tourism industry. The insurgency had created negative impacts upon would be tourists. Even the country lacks sufficient tourisms spots, luxurious hotels and parks in the tourist area of the country due to the unavailability of funds. To mitigate these physical problems, Nepal must shake joint hands with foreign governments, business firms and individuals in order to make Nepal and her nature beauty and traditional artifacts known among the rest of the people in the world on the one hand and to create sound physical infrastructure and other facilities needed for the tourists on the other.

4.5 Major Findings of the Study

Year wise flow of FDI from the year 1982 to 1989 shows only a modest rather fluctuating foreign investment both in terms of total fixed capital and authorized capital, although authorized capital is in no way an important indicator of investment. The total numbers of industries registered in the manufacturing sector between the years 1982 to 1989 were 48, which involved the total fixed capital of Rs.1123.2 million and in the service, tourism and other sectors registered 26 industries, which involved the total fixed capital of Rs.808 million. Thus, the study shows that the number of industries established under FDI was very insignificant during these periods. One of the main causes behind this slow increment might be the restrictive laws and policies adopted by the government. The policies were not investment friendly. In the subsequent period of 1980s Nepalese economy was suffering from various macro economic crisis like increasing negative balance of payment, high rate of inflation, growth of debt burden, budget deficit etc, due to which it was difficult to attract FDI in Nepal. Along with this the other causes which were responsible for the slow flow of FDI were the shortage of electricity in that period from which Nepal was suffering, which is very essential for establishing industries and for attracting FDI into the country. Besides this, the country was suffering from poor infrastructural facilities like roads, communication etc. Roads are the backbone for market extension and the necessary condition for economic activities. Lack of adequate transportation system would raise the cost of production thereby eroding competitiveness in the international market. The same period also witnessed inadequate and inefficient communication facilities. So, all these causes were responsible for the low FDI during these periods.

The size of FDI was confined to Rs.1209.95 million in 2003/04. During the last twelve years between 1990/91 to 2004/05 trends in FDI were found to be erratic, jumping from Rs.466.8 million in 1990/91 to Rs.3083.67 million in 1994/95, and for the next two consecutive years it declined. And then in 1997/98 it started to increase and this trend lasted only for two years. Again FDI continued to decline for three consecutive periods between 1999/00 to 2001/2002. Take off in FDI was further visualized in 2002/03.

However, FDI has decelerating trend in recent years that confined to Rs.311.08 million in 2006/07.

Thus, from study we can conclude that the flow of FDI projects in the beginning of 1990s was encouraging. The main cause behind this was the incorporation of various facilities in the Foreign Investment and Technology Transfer Act (FITTA-92), and Industrial Enterprise Act (IEA-92), which were not in existence prior to 1992. In these acts various facilities like, repatriation facilities, visa facilities, various tax incentives, convertible foreign exchange facilities, land facilities were offered to foreign investors and hence foreign investors have shown interest in investing in Nepal in the early 1990s.

Sector wise flow of FDI in Nepal indicates that FDI has flowed mainly into the manufacturing units. However, manufacturing sector includes industries relating to medicine, packaging materials, diesel pump sets, television/telephone, plastic tank, silk and polyester, readymade garments, suiting/shirting/saree, residential and commercial complex, paints, white sugar, dairy products, mineral water, hair oil, tooth powder/tooth paste, cement, laminated tubes, iron rods, bakeries, leather shoes and leather tanning, fertilizers, soap, biscuits and confectionary, dry cell battery, lubricating oil, menthol crystal, refractory bricks, cotton/synthetic textile, electrical bulbs, cigarette, copper utensils, copper enamel wire, tyre-retreating, and ice cream etc. Manufacturing sector has succeeded to attract FDI to the level of Rs.9033.48 million, which is 38.9 percent of total FDI. The flow of FDI is highest into the manufacturing sector, which is mainly because the goods produced in this sector are consumed in the market easily and also gets relatively easy access to the international market. The goods which are easily sold in the market attract more FDI. Along with this, availability of cheap labor cost has also attracted FDI in this sector.

The highest number of employment (60619) is provided by manufacturing sector, which provides 61.8 percent of the total employment, followed by textile, tea and garment industries (32873), which are 33.5 percent of the total, hotel and resort industries provide employment to 14.8 percent of the total which come next in this regard.

The country wise flow of FDI in Nepal shows that in total, investors from forty eight different countries have invested in Nepal but the scale and number of projects in most cases is very small. FDI is reasonably concentrated with seven countries accounting over four-fifth of cumulative FDI. India alone accounted for one-third of FDI, followed by United States and then China. The study shows that the number of Indian joint venture projects is highest in Nepal (295), which is 31.5% of the total projects. China comes next after India, which has 95 joint venture projects in Nepal which is 10.16 % of the total. Japan is in 3rd position which has 88 joint venture projects in Nepal, which is 9.15 percent of the total.

The plan wise trend of FDI in Nepal especially of the last three plan periods shows that before eighth plan, 150 foreign collaborated projects were registered with the total capital investment of Rs.12235.84 million. The eighth plan had 245 projects with the capital investment of Rs.41853.45 million and the foreign investment Rs.9555.42 million. In the ninth plan period, 373 new projects with capital investment of Rs.24805.79 million and the foreign investment of Rs.9403.22 million were approved. Similarly, in the first two years of the tenth plan 159 new projects were registered with capital investment of Rs.9947.67 million and the foreign investment of Rs.6485.62 million.

From above analysis, what we infer is the intensity of foreign direct investment in terms of either capital investment or foreign investment or employment generation is concentrated in the eighth five year plan period except in number of industries in the ninth five year plan. This indicates that political stability; national consensus and maintenance of peace and security are the foremost preconditions for the foreign direct investment to flow in any country.

The survey of the present study has found many problems of foreign investment promotion in Nepal. Long procedure to initiate the business, non-implementation of preferential treatment given by the Act, bureaucratic harassment, undeveloped infrastructure and lack of human resource etc are some of them.

As per the survey result, factors motivating foreign investment in Nepal are found to be adequate availability of natural resources, cheap labor, tax and duty drawback facilities, growth of market potentials and friendly socio-economic environment. Macro economic policies-fiscal and monetary-have a little impact on their decision to invest in Nepal leaving aside the exchange rate policy. In host country determinants of FDI, policy regime and economic determinants have strong impact upon the inflow of FDI whereas business facilitation measures in Nepal are found to be poor and neutral in stimulating foreign investment in the country. The foreign investment promotion Center established with an eye to strengthening business facilitation works in the country is not as much able to facilitate foreign investors, as it should be for the promotion of foreign investment. In addition to above mentioned factors, other motivating factors affecting foreign investors' decision to invest in Nepal include the rights to get repatriation facilities, electricity facility, land facility and depreciation facility.

As per the result obtained from sample survey, the home country factors motivating foreign investment in Nepal are found to be increasing labor shortage in the home country. The increasing cost for labor and fifth level of tax at home also contributed for the investment in Nepal. The survey result revealed that the foreign investors investing in Nepal chose to invest in Nepal other than South Asian countries because of small bureaucracy, friendly socio-cultural environment and high incentives and facilities available in Nepal. The availability of cheap labor, markets and other raw materials also attracted them to invest in the kingdom.

The survey portraits that 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, increasing Maoist insurgency, instable government, instability in policies, non-implementation of facilities cam incentives, small market size, bureaucratic hassles, frequent stalemate between Indian and Nepal over trifle transit and other trade issues and inadequacies and inconsistencies in policies.

As per the survey findings, the prospective investment areas in Nepal include agriculture and agricultural related production, manufacturing industries such as ready-made garment and carpet, hydropower, tourism and service industries.

For the promotion of foreign investment in Nepal, they suggested to simplify procedures to translate promised facilities and incentives into practice, maintain peace and security and avoid inconsistencies in policies.

CHAPTER FIVE

SUMMARY, CONCLUSION AND RECOMMENDATIONS

5.1 Summary

Nepal has made a promising start in implementing market-oriented reform and promoting FDI as part of it, but it has a long way to go in reaping the benefits from the greater global integration through FDI.

Foreign investment scenario in Nepal has been dismal. Despite its free market reforms and incentives, Nepal has attracted only a small portion of foreign investment flowing to South Asia. Nepal had endeavored to infuse FDI in the economy since 1981, when acts and policies governing FDI were legislated. However, there was Indian investment in Nepal prior to the legislation of such acts and policies. The analysis of the flow of foreign investment 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. Before, 1991, as per the official record of DOI, there was no notable flow of it due to the restrictive policies imposed during the period of 1980s. The implementation of SAP and SAF paved the way for liberalizing and privatizing the economy and that contributed for increased flow of FDI up to 1994. Later on, due to the internal peace and security problem, it is found to be dwindling down.

According to the data obtained from Department of Industry, the total projects under FDI are 935, and total foreign investment is Rs.25681.66 million till January, 2007. The major investor countries are found to be India, China, Japan, USA, South Korea, UK, Germany, Singapore, Canada and Norway. The foreign investment is found to be heavily concentrated in manufacturing industries followed by energy based and tourism industries. In terms of scale of industries, the investment is focused on small-scale projects, which manifests the involvement of small foreign firms. The total approved foreign investment, if actually realized, has generated the employment opportunities to 98024 people up to 2007.

As for the actual investment made by foreign investors is concerned, there is no data record relating to such investment. The Foreign Investment Promotion Center (FIPC) under the Department of Industries (DOI) uses to keep only approved investment, which does not reflect its contribution in the growth of national income. Again, there is not any mechanism to record the actually invested figure by foreign investors. The lack of availability of actual data has constrained the impact assessment of foreign investment.

Nepal has formulated laws and policies governing FDI. Many facilities and incentives have been offered to attract FDI in the country. Before 1990, acts and policies relating to FDI were not so investment friendly, so the flow of FDI during this period was largely insignificant. After 1990s, various facilities were offered in the acts like Foreign Investment and Technology Transfer Act (FITTA-92), Industrial Enterprise Act (IEA-92), and industrial Policy-92 to attract FDI in the country. Tax exemption and deduction facilities along with duty drawback facilities are some of the measures declared in the foreign investment acts. The set up mechanism for one window facility and the attempt towards establishing EPZ are applaudable task of the government. However, the laws and policies addressing FDI are found to be inadequate and inconsistent. Though various facilities were offered after 90s, but still they are inadequate to attract good amount of FDI in the country.

5.2 Conclusion

Year wise flow of FDI from the year 1982 to 1989 shows only a modest rather fluctuating foreign investment both in terms of total fixed capital and authorized capital, although authorized capital is in no way an important indicator of investment. The total numbers of industries registered in the manufacturing sector between the years 1982 to 1989 were 48, which involved the total fixed capital of Rs.1123.2 million and in the service, tourism and other sectors registered 26 industries, which involved the total fixed capital of Rs.808 million. Thus, the study shows that the number of industries established under FDI was very insignificant during these periods. One of the main causes behind this slow increment might be the restrictive laws and policies adopted by the government. The policies were not investment friendly. In the subsequent period of 1980s Nepalese economy was suffering from various macro economic crisis like increasing negative balance of payment, high rate of inflation, growth of debt burden, budget deficit etc, due to which it was difficult to attract FDI in Nepal. Along with this the other causes which were responsible for the slow flow of FDI were the shortage of electricity in that period from which Nepal was suffering, which is very essential for establishing industries and for attracting FDI into the country. Besides this, the country was suffering from poor infrastructural facilities like roads, communication etc. Roads are the backbone for market extension and the necessary condition for economic activities. Lack of adequate transportation system would raise the cost of production thereby eroding competitiveness in the international market. The same period also witnessed inadequate and inefficient communication facilities. So, all these causes were responsible for the low FDI during these periods.

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5.3 Recommendations

Following suggestions and recommendations are forwarded to attract FDI in the country:

- As Nepal has recently become a member of the WTO, the FDI policy needs to be compatible with those of the WTO. Commitments to WTO negotiated conditions are yet to be fulfilled, which will otherwise adversely affect the investment climate. It must be underscored here that the real benefit to Nepal from WTO accession is in the area of FDI mobilization from its climatic impact from the provision of MFN and National treatment based on the rule of law as per international standards and legal norms. WTO commitments are either mandatory or voluntary. The mandatory commitments are:
  Implementation of Agreements on:
    - Custom Valuation
    - Technical Barriers of Trade
    - Sanitary and Phyto-Sanitary Measures
    - TRIPS. All these mandatory commitments has to be completed by 1st January, 2007, but until now only some of them have been partially

completed. Thus, all these commitments should be completed as soon as possible to get benefit from WTO accession

- Some changes must be done in the field of taxation. Some of them are as follows:
    - Reduce Dividend tax to zero as soon as possible which could be one of the important steps to attract FDI into Nepal.
    - Reduce custom duties to a minimum of 5% by 2010.
    - Reduce Income tax rates gradually by 15, 25 and 50 % by 2012.
    - Redesign corporate taxation to internationally competitive levels.
    - Remove tax holidays except for the pioneer and high priority industries and businesses with high-risk venture capital investments.
    - Commit to reasonable stability in tax policy.
- Although labor is cheap in Nepal, labor productivity is very low. Labor productivity can be improved by making stringent labor laws. Labor wages should be based on performance and productivity. Currently, once a labor is employed for 180 days, he is permanent and cannot be dismissed even if he is unproductive. So, labor laws should be re-designed.
- To solve the problems relating to visa, there is a need of
    - Speedy granting of visa to the foreign investors or authorized representative of foreign companies on the recommendations of Federation of Nepalese Chamber of Commerce and Industry on preferential basis or relaxed terms.
    - Granting of multiple entry visa for the businessmen and their spouses and dependents, and
    - An increase in the period of residence visa. Moreover, there is a need to simplify the visa requirements and procedures of renewal.
- Hardly any promotional measures to publicize Nepal as a potential country for FDI have been undertaken. This has inhibited the flow of FDI into Nepal. The majority of international investors have little idea about the prospects of joint-venture industries in Nepal. In order to resolve this problem, different

promotional measures should be initiated to publicize the prospects and potential of foreign/joint-venture investments in Nepal and the policy reforms undertaken by the Nepalese Government in this regard. Publicity measures such as advertisement in the television and magazines, exhibitions, and trade fairs should be utilized every now and then in major cities of the world where prospects of FDI prevail. In this respect ministry of foreign affairs and Nepalese diplomatic missions have an instrumental role to play in image building and promotion. Information relating to the investment opportunities in Nepal, the facilities provided to the investors, and the possible benefits to the investors owing to the potential resources in Nepal should be disseminated.

- Nepal must venture for smooth functioning of regional and sub-regional bodies like SAARC and SAGQ. The proper functioning of these regional bodies will promote foreign investment in the regions. This is also essential, as the big foreign multinationals do not pay attention in the country like Nepal where access to the market is very small along with a small resource base. So, special treatment to the multinationals of SAARC countries should be given to penetrate Nepalese as well as Indian and Tibetan markets.
- FDI can also be flowed into the country from Non-Resident Nepalese (NRNs). With regard to attracting FDI from Non-Resident Nepalese (NRNs), the budget for FY 2002/2003, for instance, stated that steps would be taken to simplify the licensing procedures and repatriation from such investment in the currency of investment. The provision of ten year multiple entry visa to NRNs willing to invest in Nepal has already been made effective. Still, separate laws should be devised to attract investment from NRNs.
- The law and order situation is very crucial to foreign investors in making their decision to invest given that they need to stay in Nepal with their families. Security concerns about themselves and their families are an important factor. A poor law and order atmosphere puts prospective investors on the sidelines. So, there must be the fearless situation for investors. For this government can play an important role.

The attraction of FDI has become very competitive. Being a small landlocked country, Nepal has to make extra efforts to counter balance the negative impact of the competition by implementing several policy measures. It has to offer more generous and attractive incentives to potential investors partly to demonstrate the fact that it has to compete with other countries. On the investors' side, apart from attractive incentives, they also consider other factors such as political stability, sound macroeconomic policies, continuity in government policies, adequate infrastructure facilities, equal treatment of foreign and local firms, a good legal environment, competitive labor cost and good labor practices, skilled labor force, ample natural resources, access to export market, the availability of appropriate domestic partners for joint-ventures, and the provision of better information on investment opportunities. If these factors are inherent in Nepal, the future prospects of FDI could grow to become a powerful force for the development of the country as a whole.

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