FOREIGN DIRECT INVESTMENT IN NEPAL
WITH SPECIAL REFERENCE TO THE SERVICE SECTOR

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By

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LETTER OF RECOMMENDATION

This thesis entitled "FOREIGN DIRECT INVESTMENT IN NEPAL WITH SPECIAL REFERENCE TO THE SERVICE SECTOR" has been prepared by Mr. Rupesh Raj Khanal under my supervision. I hereby recommend this thesis for examination by the Thesis Committee as a partial fulfillment of the requirements for the Degree of MASTER OF ARTS in ECONOMICS.

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LETTER OF APPROVAL

We certify that the thesis entitled "FOREIGN DIRECT INVESTMENT IN NEPAL WITH SPECIAL REFERENCE TO THE SERVICE SECTOR" submitted by Mr. Rupesh Raj Khanal to the Central Department of Economics, Faculty of Humanities and Social Sciences, Tribhuvan University in partial fulfillment of the requirements for the Degree of MASTER OF ARTS in ECONOMICS has been found satisfactory in scope and quality. Therefore, we accept this thesis as a part of the said degree.

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Finally, as I did the typing and formatting of the whole texts in computer, I bear full responsibility for any errors and discrepancies that might have occurred in the research-report.

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LIST OF ACRONYMS

CBS	Central Bureau of Statistics
CEDA	Centre for Economic Development and Administration
CEDECON	Central Department of Economics
DCs	Developed Countries
DoI	Department of Industry
FDI	Foreign Direct Investment
FITTA	Foreign Investment and Technology Transfer Act
FNCCI	Federation of Nepalese Chambers of Commerce and Industry
FY	Fiscal Year
GNP	Gross National Product
GoN	Government of Nepal
IEA	Industrial Enterprises Act
IMF	International Monetary Fund
IP	Industrial Policy
JV	Joint Venture
LDCs	Least Developed Countries
MIGA	Multilateral Investment Guarantee Agency
MNCs	Multinational Corporations/Companies
MNEs	Multinational Enterprises
MoF	Ministry of Finance
MoICS	Ministry of Industry, Commerce and Supplies
NEFAS	Nepal Foundation for Advanced Studies
NPC	National Planning Commission
NRB	Nepal Rastra Bank
NRN	Non-Resident Nepali
Rs.	Rupees
R & D	Research and Development.
SA	South Asia
SAARC	South Asian Association for Regional Cooperation
SAFTA	South Asian Free Trade Area
SWATEE	South Asia Watch on Trade, Economics and Environment.
TU	Tribhuwan University
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNICTRAL	United Nations Commission on International Trade Law
UK	United Kingdom
USA	United States of America
WB	World Bank
WTO	World Trade Organization

CHAPTER I
INTRODUCTION

1.1 General Overview

Located between the world's two fastest-growing economies- India and China, Nepal is a Least Developed Country (LDC) in the South Asian Association for Regional Co-operation (SAARC) region. Being one of the poorest countries in the world, the per-capita GNP of this country has reached dimunitive of US $ 300 up to FY 2004/05. Approximately, 31 percent of the total population is below the abject poverty line. At the same time, the gap between the rich and the poor is widening at an alarming rate. This reflects that a chronic vicious circle of poverty exists in the economy.

Looking on the structure of the economy, majority of the population depend on agriculture which has been employing obsolete technology and unskilled manpower generating very less volume of saving making up less capital formation and, consequently, less volume of investment. Due to the resource crunch, the government has not managed to create sufficient job opportunities inside the country as-a-result of which youths are heading for foreign lands *en mass* in search of livelihood. On the other hand, political instability has been, for a long time, suffering the economy most. However, there is a general expectation that the Maoists' insurgency will be resolved in near future as the both sides- the government and the Maoists have been engaged in peace talks, declaring the truce.

Against the backdrop, the major issue faced by the Nepalese Economy at present is, in essence, how to escape from poverty trap or low level equilibrium trap, and accelerate economy towards a great leap to catch up with the developed countries (DCs) by attaining sustainable high economic growth rate, which certainly require optimal utilization of the available natural and capital resources.

Among other factors of production, capital is an important factor affecting the economic growth which is generally found to be scarce in underdeveloped countries like Nepal. That is why the government has been making every effort to generate capital resources. But the desired level of capital resources has not come up internally compelling the government to go for external capital in the form of foreign assistance as the final resort. Due to the fact that foreign aid/assistance is not a reliable source, the governments of developing countries and LDCs have been striving to attract foreign investments. At present, each and every country in the world, whether they are DCs or LDCs, have realized the constructive and productive role of foreign investments in the economy.

In fact, Foreign Direct Investment (FDI) provides fund along with manpower, technology which are supposed to encourage local enterprise to invest with foreign investors. Especially in case of LDCs, this paves way for expansion, modernization and development of the vast rural economy helping to materialize the dream of industrialization. Besides, FDI makes available ample employment opportunities to the local people. It further brings in new and innovative know-how or skills of production and distribution/marketing. It is regarded as a powerful means of transfer of technology which helps strengthen the trade along with widespread market within and outside the country. In this way, it also assists to maintain and utilize the available capital and natural resources to the maximum possible extent so that a country may get every ambience to prosper.

Talking about Nepal's efforts to attract FDI, it began in the Sixth Plan with the promulgation of the Industrial Policy (1981) which had made a separate provision as to foreign investment, the elected government after the restoration of multiparty democracy explicitly adopted the new policy of liberalization to speed up the process of industrialization through mobilization of the local capital as well as attraction of foreign investment and technology in the country introducing a host of acts and policies. With the same spirit, Nepal, later in 1994, became a member of Multilateral Investment Guarantee Agency (MIGA), which guarantees foreign investors against non-commercial risks.

From above it is crystal-clear that Nepal has endeavored to increase the influx of FDI into the country for achieving the rapid and robust economic development. In the present context of globalization intensified by the apex global trading systems, the fruitfulness of the WTO membership to Nepal, to large extent, depends on how much foreign investment and transfer of technology it can invite to extend the national production frontier and sharpen competitive edge of the economy.

1.2 Statement of the Problem

According to the Constitution of the Kingdom of Nepal, 1990, "The State shall, for the purpose of national development pursue a policy of taking measures necessary for the attraction of foreign capital and technology, while at the same time, promoting indigenous investments." In the same manner, the Tenth Plan (2002-07) has the objective to develop Nepal as an attractive and reliable investment center at international perspectives, making the procedures to attract foreign investment simple, comprehensive and transparent through administrative and legal reforms. This shows that the country has accorded high attention in attracting higher amount of FDI into the economy.

However, the reality is that over the two decades, foreign investment has been growing but in a slow pace. Complaints and grievances from foreign investors on the problems they happen to face before and after investing in Nepal have been heard frequently. Though FDI is among the national economic priorities, there is lack of study and analysis on this subject. Therefore, the proposed study is a genuine effort to analyze the trend of the FDI in general and FDI in the Service Sector in particular.

The rationale behind the GoN to emphasize on attracting FDI is that the country wants to collect the funds to utilize the available resources in the country. But the amount of FDI has not been to the desired level in spite of some improvements in the legal provisions and increased facilities. Likewise, in spite of growing popularity of the FDI in the Service Sector globally, it has not increased in Nepal.

Realizing the significance and role of foreign investment, especially overall FDI, in economic growth and development of the country, an analysis of overall FDI and FDI in the Service Sector with the aim to find the ways for future improvements for FDI industries in general and FDI in the Service Sector in particular has, thus, been taken as the problem of the proposed study.

1.3 Objectives of the Study

The study is aimed at the following objectives to:

1. take account of the legal status of FDI in Nepal.
2. examine and analyze the nature and extent of overall FDI and the employment opportunities and transfer of technology through FDI.
3. examine and analyze the FDI and employment generation in the Service Sector.

1.4 Significance of the Study

Since the domestic resources are insufficient and difficult to mobilize and the government has to speed up the process of sustainable development under the severe resource scarcity, the government is trying hard to attract FDI inside the country. However, the desired level of FDI has not come forth to date. Moreover, no specific study on the FDI in the Service Sector in Nepal has been conducted so far. Considering this fact, the study will be useful for the policymakers at the planning level to improve the legal provisions and incentives to be offered. Likewise, this study will be helpful to the students alike.

1.5 Limitation of the Study

The study is mainly focused on the direct investments by the foreign ventures only. It excludes the analysis of the portfolio investment made by the foreigners. The study will be, to some extent, limited in scope and coverage due to time and resource constraints. The study takes into considerations basically the trend of FDI in the Service Sector of Nepal and recommendations for its promotion.

1.6 Organization of the Study

This thesis has been broadly divided into seven chapters. The first chapter presents the introduction to the subject-matter of the research, comprising of general overview; statement; objectives; significance and limitation of the study. Review of the literature is the second chapter presented in two sub-heading under global scenario -- the literatures by the foreign scholars and institutions -- and the Nepalese scenario -- literatures by the Nepalese scholars and institutions. The third chapter is concerned with the methodology of the research that covers research design, source of the data, the procedures of data collection, and procedures of data processing and the method of data analysis.

Similarly, the fourth chapter is the theoretical and historical aspects of FDI. Under theoretical aspect, the definition; types; theories of FDI are dealt with. In addition, host country determinants and pros and cons of FDI along with the definition and the history MNCs are also presented. Under historical aspect of FDI, FDI in the global and Nepalese context has been put forth. Likewise, the fifth chapter takes account of the current legal framework of FDI in Nepal.

The sixth chapter is the most important section of the thesis, concerned with the presentation and analysis of the data. This chapter has broadly been divided into two parts -- analysis of overall FDI -- statuswise, sectorwise, categorywise, countrywise, districtwise and yearwise separately in the case of amount of FDI at first and employment generation and technology transfer. In the analysis of the overall FDI in the basis of year, a Simple Regression Model has been fitted so as to forecast the future trend. Likewise, the later part is presented in the like manner, which includes the specific analysis of the FDI in the Service

Sector in the perspective of the FDI amount, employment generation and transfer of technology. Besides, the Simple Regression Model has also been applied in this case as well.

The seventh chapter is the final one with the title of finding and recommendations. This chapter has two broad divisions -- the major findings stating the key results of the study are in the first part, followed by the recommendations dealing with the ways for the promotion of the FDI in the Service Sector. The references and links and the annex concludes this thesis.

CHAPTER II

REVIEW OF THE LITERATURE

This Chapter presents the review of related literature published over the years which aims to provide an insight to the concept and related issues of foreign direct investment (FDI). The various studies regarding the research-questions conducted in course of time by different scholars have been sought to record.

2.1 Global Scenario

Broadly speaking, an interest on foreign investment seems to have taken place after the World War II, when many a country freed from the ages-long colonism. The developed countries started to adopt an extrovert or so called outward-looking economic polices. The wave of globalization also added fuel to the fire, in making foreign capital a global phenomenon, which later gave rise to multinational companies/corporations (MNCs). However, the then developing countries were not in a mood to accept the mobilization of foreign capital, especially foreign investment initiated by developed countries, rather they were skeptic about the behavior of the developed countries thinking that the latter would again re-establish the colonial system. Later, around 1980s with the epoch-making development in telecommunication and transportation in a speedy manner, the whole world deviated from the orthodox notion of 'inward' looking economic policies to a more flexible and 'outward' looking economic policies. Similarly, there was a new realization on the part of developing country that they could not simply afford to remain isolated ignoring the then global liberal policies. Moreover, the developing countries adopted the liberalization policies not at their own will, but the contemporary economic crises -- such as debt crisis -- made them to do so, as the developed countries asked the former ones to do. Along with these developments, the developing as well as developed countries have now realized the productive role of FDI.

Thus, in the global context, there is lots of literature available as to FDI. Generally speaking, the literatures -- especially before early 1980s -- viewed the role of foreign investments critically, while those of the later 1980 and onwards appear to have been more empathetic on the positive role of FDI that can play in an economy.

The New Palgrave A Dictionary of Economics (1987, vol. II), edited by John Eatwell, Murry Milgate and Peter Newman comprising a piece of writing by Herbert G. Grubel defines FDI as the act of acquiring assets which may be financial, such as bonds, bank deposits, equity shares or they may be so-called direct investment and involve the ownership of means of production such as factories and land. Direct investment is also considered to take place, if the ownership of equity shares provides control over the operation of a firm.

Further, there are other motives for the purchase of assets abroad. They involve either externalities or market imperfections, which are internalized or eliminated by the Multinational Enterprises (MNEs). The final major explanation of FDI involves distortion introduced by the government policies. Tariffs and other protective devices as well as subsidies and taxes can create conditions under which it is more profitable to produce in, rather than export to, a foreign country.

The McGraw Hill Encyclopaedia of Economics (1994, second edition), edited by Douglas Greenland, comprises of an article by M. Graham Edward entitled 'FDI: General Agreement on Tariff and Trade, Joint Venture, Multinational Corporation, Nationalization of Industry, Protectionism' that describes FDI as the acquisition of managerial control by a citizen or corporation of a home nation over the corporation of some other host nation. Corporation 'that widely engage in FDI are called are 'Multinational Companies', 'Multinational Enterprise' or 'Transnational Corporation'. The term is something of misnomer: when FDI takes place, investment in economic sense may or may not occur. If, for example, a US company acquires ownership of the ongoing British firm, FDI is seemed to have taken place, however, no net creation of productive capital and hence no economic investment has occurred. By contrast, if the same US Company creates *de novo* subsidiary in Great Britain, building new plant and equipment, then both FDI and economic investment have taken place.

Exactly why FDI should take place at all has been the subject of considerable inquiry in recent years, the point having been made in a world characterized by perfect markets for goods and factor of production, FDI would not occur. This argument that imperfections in these market must account for FDI and theories based on imperfections in foreign exchange markets, financial markets and markets for technology have been advanced

The Oxford Economics Dictionary (1997) edited by John Black states that FDI is the acquisition by residents of a country of real assets abroad. This may be done by remitting money abroad to be spent on acquiring land, constructing building mines or machinery or by existing foreign business. Inward FDI similarly is acquisition by non-residents of real assets within a country.

Meier, Gerald M (1984) in his book entitled 'Leading Issues in Economic Development' (forth edition) has made a brief note on private foreign investment, its benefits and costs, Transnational Corporations (TNCs) in developing countries and finally transfer of technology. According to him, the essence of the case for encouraging an inflow of capital is that increase in real income resulting from the act of investment is greater than the resultant increase in the income of the investors. The benefits of private foreign investment can accrue to (a) domestic labor in the form of higher real wages (b) consumers by way of lower prices (c) the government through higher tax revenue and most importantly, there are likely to be (d) indirect gains through the realization of external economies. Against these benefits, the costs may arise from special concessions offered by the host country, adverse effects on domestic savings, deterioration in terms of trade and problems of balance of payments. In connection to TNCs, he explains that TNCs may change the nature and evolution of concentration,, they may affect the profitability and growth of indigenous firms, they may alter financing, marketing, technological and managerial practices of the sectors that they enter, and they may, by predatory conduct, drive firms out of business, and so on.

In sum, he concludes that the central problem now is for the recipient country to devise policies that will succeed in both encouraging a greater inflow of private foreign capital and ensuring that it makes the maximum contribution feasible toward the achievement of the country's development objectives and the tasks of development require both more effective governmental activity and more investment on the part of international private enterprise.

Later in 1995, the author brought out the book entitled 'Private Foreign Investment in Developing Countries', in which he appeared positive on the role of foreign investment. What he wrote is that governments of developing countries were giving new attention to the potential for private foreign direct investment in their economies. This is the reason why many developing countries were eager to extend the market price system and the private sector and to mitigate the external debt problem by attracting more private foreign investments.

The literature review of two books by the same author implies that as time elapsed, the attitude toward FDI has been changing from suspicion to a greater degree of reliability. A probable reason, among other things, of the paradigm shift could be advice of the advanced countries to the developing countries and compulsion of the developing countries themselves on the other.

Torado, Michael P. (1985), in his widely-acclaimed book entitled 'Economic Development in the Third World' has briefly described few pros and cons of private foreign investment in the development drama of the Third World. The contribution of private foreign investment to national development have been claimed in terms of filling gaps- the resource gap, foreign exchange gap, the gap in the management, entrepreneur, technology and skill presumed to be partially or wholly filled by local operations of private foreign firms.

The reasoning against MNCs are expressed in terms of widening gaps that consists of its long-run impact to reduce foreign exchange earnings, on both current and capital accounts, uneven impact on development, income-inequalities, production of inappropriate products, stimulation of inappropriate consumption patterns through advertising and monopolistic market power with the help of inappropriate (capital-intensive) technologies of production, allocation of local resources for socially undesirable projects aggravating the already sizable inequality between rich and poor and the serious imbalance between urban and rural economic opportunities, use of their economic power to influence government policies in directions unfavorable to development, high possibility of damage of host economies by suppressing local competitors, and small-scale local enterprises, control over real local assets and jobs exerting considerable influence in political decisions at all levels.

Tuller, Lawrence W.(1992) in the book entitled 'Mc Graw Hill Handbook of Global Trade and Investment Financing' mentions that FDI financing being long term usually involves large amounts of capital and may include a wide variety of possible variations and combinations of debt and equity. Once the project is up and running, additional funds may be required for working capital. The argument here is that for domestic expansion projects or business acquisitions through FDI calls for a smooth financing mechanism in the economy.

The author has noted the source of funds for foreign investments that are significantly different from those encountered in a domestic expansion. They fall broadly into seven categories:

1. Joint ventures
2. Host country commercial banks
3. Regional or local development banks
4. Bilateral financing aid organization
5. Multilateral financing aid organization
6. Local stock markets
7. Counter trade

The author has also presented a comparative study of G7 countries (US, Great Britain, France, Italy, Canada, West Germany, Japan) on FDI inflows among which the US had received the most portion of the FDI chunk.

UNCTAD (1998), a UN publication entitled 'FDI in Selected Asian Countries: Policies, Related Institution Building and Regional Cooperation' reflects the changing philosophy and role of FDI. A dramatic shift in the attitude of developing countries towards FDI has become evident since mid 1980s following the 'debt-crisis' of the early 1980s which caused spectra of falling investments, declined or even negative growth, soaring fiscal deficits and deteriorating balance of payments. The developing countries then cried out for financial assistance and policy recommendation to the developed ones that the former were required to open up their economies to FDI, leading to the emergence of TNCs in a vast spectrum of economic activities. Many TNCs moved into manufacturing activities in developing countries with greater possibilities for forward and backward linkages. Many of them engaged in export-oriented manufactures, complementing the national development objectives of achieving improved balance of payments and rapid industrialization simultaneously. In the context of export promotion, the role of TNCs has been assuming greater significance with the increasing importance of intra-firm trade in global trade.

TNCs were being increasingly looked upon as a source not of capital only but also of promotion, management and marketing techniques. Thus, many developing countries initiated liberalizing their FDI policy regimes on the basis of the new perception of community interest. The trends towards liberalization become progressively more widespread as a result of 'demonstration effect', as some countries liberalized, others followed suit.

In-a-nutshell, the above-mentioned factors have been complemented by other supportive changes in the global economic view. These changes involve greater 'componentization' of production, convergence of demand patterns and reduced cost of cross-border transport and communication which have paved way for favorable condition for a greater number of developing countries to attract FDI.

UNCTAD (2003), a UN publication entitled 'Investment Policy Review Nepal' deals with FDI trends and performance, investment framework and FDI strategy. The study finds out that the volume of FDI inflow into Nepal has been small hindering FDI to become an important source of aggregate investment finance and its impact on economic development has been minimal. A comparison with the selected high and low performing Asian countries brings out the underperformance of Nepal in terms of FDI inflows, thanks to failure on the part of the government to offer incentives to the investors, unsatisfactory administration, barriers in the power generation and political instability. As Nepal has some niche sectors such as tourism and herbal products, immense potentiality exists for the country to attract FDI in such sectors. Even though most sectors are open to FDI and the standard of treatment has been fairly good, the FDI potential has not materialized. An overall improvement in the business climate is called for to make it more investment-friendly.

The study recommends to attack the key obstacle to FDI through liberalizing foreign investment law concluding a bilateral investment treaty with India; improving administration and design of taxation in particular; modernizing labor regulation; appointing a champion of investors' rights; creating industry promotion packages to tap immediate FDI potential in tourism, export manufacturing and herbal products mandating a special investment agency.

Cho, Joong-Wan (2003) in the book 'FDI: Determinants, Trends in Flows and Promotion policies' published by Investment Promotion and Enterprise Development Bulletin for Asia and the Pacific (No. 1) United Nations, has analyzed FDI from both practical and theoretical standpoints. Globalization has many faces; however, it is first and foremost comprehended in economic and financial terms. Perhaps, the most important face of globalization is the rapid integration of product and financial market over the last decade. Trade and investment are the prime driving forces behind globalization FDI has been one of the core features of globalization and the world economy over the past two decades. It has grown at unprecedented pace for more than a decade with only a slight interruption during the recession of the early 1990s. More firms in more industries from more companies are expanding abroad through direct investment than ever before, and virtually all economies now compete to attract MNEs. For the purpose, the past two decades have witnessed an imparalled opening and modernization of economies in all regions, encompassing deregulation, deconsolidation, privatization and private participation in the provision of infrastructure, and the reduction and simplification of tariffs. An integrated part of this process has been the liberalization of foreign investment regions, with the realization that FDI can play a key role in improving the capacity of the host country to respond to the opportunities offered by global economic integration, a goal increasingly recognized as one of the key aims of any development strategy.

Jensen, Natham M. (2006), an Assistant Professor of Political Science at Washington University in St. Louis, in the book entitled 'Nation-states & the MNCs: A Political Economy of FDI' reviewed and posted in the website *www.pupress.princeton.edu* presents the most systematic exploration to date of the questions-- 'what makes a country attractive to foreign investors?', 'To what extent do conditions of governance and politics matter?' at the nexus of politics and economics. Using quantitative data and interviews with investment promotion agencies, investment location, consultants, political risk insurers, and decision-makers at MNCs, the author arrives at a surprising conclusion that countries may be competing for international capital but government fiscal policy- both taxation and spending- has little impact on MNCs' investment decisions. The book is enriched with the facts and figures and has employed analytical and descriptive approach to account on determination, trends, inflows and promotion policies.

Although government policy has a limited ability to determine patterns of FDI inflows political institutions are central to explaining why some countries are more successful in attracting international capital. First, democratic institutions lower political risks for MNCs, leading to massive amounts of FDI. Second, political institutions lower political risks for MNCs, and allow host countries to attract higher levels FDI inflows. Third, the IMF, often cited as a catalyst for promoting foreign investment deters MNCs from investment in countries under IMF programs. Even after controlling for the factors that Low Countries to seek IMF support, IMF agreements are associated with much lower levels of FDI inflows.

2.2 Nepalese Scenario

Nepal started some efforts to attract FDI inflow, lately since the Sixth Plan (1980-85) with the promulgation of Industrial Policy 1981. However, interest toward FDI aroused only after the restoration of multiparty democracy in 1990s, when the elected government decided to adopt liberal economic policies. There is relatively a dearth of literature on FDI in Nepalese context, though the studies on the FDI have been conducting over the few years by the government agencies as well as some non-government ones. Moreover, the literatures on the FDI in the Service Sector are virtually absent. With this background, this section takes a glance on the studies, write-ups by Nepalese writers in different time period.

Shrestha, Amrit Man (1996) in his book entitled 'Export Promotion Directory of Nepal', a handy guide to the prospective investors to sort out the complimentary investment climate in Nepal, has primarily stressed on the role of Nepal Industrial Development Corporation in promoting foreign investment in Nepal. The book takes a glance on Nepal's export promotion policy.

Poudyal, Sri Ram (1999) in his book under the title 'Trends in Nepalese Economy: Foreign Trade and Investment' states that FDI would enter Nepal only if the investors were ensured for maximum profit. Nepal, a low cost economy by dint of abundant labor and low wage rate are strengths for attracting FDI. But the component of labor in the total cost is declining significantly with the increasingly larger use of high-tech components. Moreover, the unskilled nature of labor eliminates the advantage of low cost. Thus, it is imperative to concentrate on producing skill and technical manpower by orienting the educational system and operating for a co-coordinated approach by the universities in line with the emerging demand of international business.

Dahal, Madan K and Aryal, Shankar (2004), in the article entitled 'FDI in Nepal with reference to Indian Joint Ventures' in the book 'Nepalese Economy Towards Building a strong Economic Nation-State', CEDECON, TU have analyzed the FDI inflow into Nepal in a comprehensive manner providing historical background, national objectives, legal framework, bottlenecks and potential areas of strengths and Indian Joint Ventures (JVs) with the use of primary as well as secondary data sources.

In a poverty-stricken economy like Nepal where internal resources are extremely limited to supplement current expenditures causing increasing dependence on foreign aid (grants and loans). Against poor economic growth rate and escalating political conflict, the role of FDI is crucial not only to sustain development activities but also for poverty alleviation.

Nepal and India both have liberalized foreign investment policies that would help promote FDI in Nepal. However, foreign investment policies in Nepal are relatively inward looking, requiring adjustment with small cottage industries and industries of national importance. Review is imperative in some FDI barred areas. It is also essential to improve the capacity of domestic industries ensuring competition as per the provisions made by WTO and SAFTA.

The strengths are moderately fair investment climate; location between the two potentially largest markets in the world China and India; macroeconomic stability and a relatively liberal economy; trainable and low cost workforce; substantial natural and cultural assets; and small and accessible bureaucracy and a generally business-friendly government. The opportunities are tourism; a variety of niche agriculture and business activities; hydropower generation and infrastructure development and IT-based services. Major weaknesses comprise landlockedness, poor infrastructure, unskilled workforce, rigid and intrusive legislation, political instability, weak implementation and persistent corruption followed by ongoing insurgency.

FNCCI (2005), Nepal and the world A Statistical Profile 2005 is a source of data on various sectors of the economy with global economic comparison, which has portrayed Nepal as a country to attract much less FDI inflow. This includes the data on joint ventures, and presents the present situation of the economy as well as legal provisions and useful information to the foreign investors. This can be useful to prospective investors as they can discern about the overall investment climate in the country.

Bista, Raghu Bir (2005), in the book entitled 'FDI in Nepal', has highlighted the positive impacts of FDI on national economy in terms of employment generation, GDP and government revenue. With the help of recent facts and figures, the methodology of the study is generally descriptive. The book has a prime goal of making impact assessment of FDI at macro- and micro-levels. He asserts that as there are capital and technology bottlenecks in Nepal's industrial development, despite a huge natural potential, FDI can be helpful. He also has analyzed the FDI contribution in enhancing corporate social responsibility in Nepal. The author gives some quite interesting facts on historical background of FDI, its trends and structure in Nepal and how FDI affects the social and economic sector of the country.

Chitrakar, Ramesh C (1986), in the research-work entitled 'Foreign Investment in Nepal' (1986) CEDA, TU, has made a comparative study of foreign policy of Nepal with various developing countries on the basis_of primary and secondary data, which was conducted in the population size of some 49 firms, of which 20 were selected purposively. The objectives of the study were to examine and analyze the nature and extent of foreign investment in Nepal, analyze the policies and incentives, strategies of MNCs for overseas production, analyze the problems of promoting foreign investment in Nepal, examine the impact of the then-formed Solidarity Ministerial Meeting and Investment Promoting in investment promotion in Nepal.

The study portrayed the dismal performance of attracting foreign investment to Nepal, in spite of different efforts made by the government. He finds out that the most-important motivating factor for foreign investors to invest in Nepal is access to market by way of tariff and non-tariff restrictions imposed or expected to impose by the government on the goods which are planned for production; incentives and growth of market potential; income tax facilities; custom duty and sales tax facilities on the imports of factors of production like machinery; equipments and tools; raw materials, facility of convertible foreign currency; expansion program of the investing firm; locally available raw materials; low production costs and English-speaking familiar economic and commercial environment.

Bhatta, Shiv Raj (1993), in his thesis entitled 'Foreign Investment in Nepal' submitted to CEDECON, TU examined the impact of foreign investment in economic development of the country, problems of foreign projects and development of joint ventures. He had employed descriptive research methodology with the objectives as those of earlier author. He found many problems of foreign investment promotion in Nepal --such as -- skill shortages, inadequacy of the domestic infrastructure, small size of the country, bureaucratic harassment and lack of human resources.

The same author came up with the article entitled 'A Case for FDI' (*The Himalayan Times*, 2 May, 2005) suggesting that there should be some restrictions on FDI. Basically, protection of certain sectors and industries (cottage and small-scale industries, arms, ammunition and security-related industries) and restraining employment of foreigners are desirable.

Rai, Parker (2003), in his thesis entitled 'FDI in Nepal: Problems and Prospects' submitted to CEDECON, TU, with the objectives to analyze the prospects for and problems of FDI inflow to Nepal; examine the nature and extent of FDI; employment opportunity and technology transfer; the existing policies and incentives to FDI. The study has adopted descriptive and exploratory method, employing primary source and secondary source. He has also fitted a regression line to analyze the trends of FDI in Nepal.

According to the study, there is an increasing trend of the FDI inflows; positive trend in employment opportunity. However, Technology Transfer has been adversely affected due to topographical problem, frequent change of the government, corruption, heavy excise duty to mention just a few.

Dangol, Madhav (2003), in his thesis entitled 'Problems and Prospects of FDI in Nepal' submitted to CEDECON, TU has analyzed the then phenomena of FDI. He set forth the like objectives of examining the problems and prospects of FDI in Nepal. His study is based on the descriptive research methodology.

His findings include that there is no mechanism to record the actual figures of investments to foreigners, giving rise to a paucity of necessary data. Likewise, Nepal's performance on attracting higher FDI has been found to be very poor, despite a host of incentives provided by the government. He has suggested developing infrastructures, establishing R & D institutions, implementing the government policies effectively, integrating the national economy and practicing good governance for the promotion of FDI in Nepal.

Bhandari, Jay Prakash (2005) in his thesis entitled 'An Analysis of FDI: A Case Study of Trend, Structure and Legal Provision for FDI in Nepal' submitted to CEDECON, TU has conducted the study to find out the strengths and weaknesses of the country to attract FDI in the economic development of the country, making use of some statistical tools to arrive to some conclusions.

He has observed that the lacunas in FDI promotion in Nepal are: lack of chain relation between foreign investment and other commercial laws; inadequate facilities and concessions; insufficient acts to protect intellectual property and unfavorable labor acts to export-oriented industries.

Pant, Bhuwanesh (1994) in the article entitled 'FDI: Benefits, Cost and Determinants' in the Economic Journal of Nepal (July-Sept.), CEDECON, TU has given the FDI-friendly philosophy with a short background in the global scenario. He wrote that from 1985 to 1990, global FDI grew four times faster than global GDP and twice as fast as domestic investment. During 1991, 25 Countries made 82 changes in FDI policy. Nearly all of these changes were in the direction of greater liberalization of FDI. The determinants for attracting FDI are political and economic stability; sound macroeconomic environment and growth potential; credit worthiness; export market access; adequate and transparent regulatory regime; technological and managerial advantages; government regulations and tax policy. The same author, later in 2005, came up with the article entitled 'FDI: Some Theoretical and Practical Issues' in *Mirmire* (2005), an NRB publication in which he has briefly dealt with the theoretical and practical issues related to FDI.

Arya, Ramesh C (1994), in the article entitled 'Foreign Investment and Technology Transfer: The Nepalese Experience' in the Economic Journal of Nepal, (1994, July-Sept), CEDECON, TU has focused on the policy implications of FITTA in Nepal's own experience. He has argued that the projects promoted as foreign investment are of smaller magnitude which do not have high technological contents and are serving the domestic market only. He has made an important point that industrial environment should be made favorable for local investors, before expecting more FDI to flow in.

Pyakuryal, Bishwambhar, (1995) in the book entitled 'Impact of Economic Liberalization in Nepal' has analyzed the effect of economic liberalization in attracting foreign investment in Nepal. The study is solely with the aim to assess the impact of economic liberalization on various sectors of the economy, based on data of secondary source published by different government agencies.

He has made some significant conclusions. Firstly, industrial restructuring demands reinforcing competitive pressures. Breaking up monopolies and motivating private sector entry should be prioritized, as monopoly of selected industries would have adverse effect on the liberalizing imports. Secondly, broad-based industrial development strategy has been weakened because of country's smallness and poor resource-base. The reorientation of policy emphasis is needed to strengthening specialization in industries in which Nepal possesses a comparative advantage based on its human resources. Thirdly, the study shows a significance correlation between promotional programs and the success of the countries in attracting foreign investment. Finally, competition for FDI has intensified in recent years because of a potentially declining supply of FDI and limited scope for receiving development finance from the international banking sector. Strategies should, thus, be developed on marketing programs for attracting investment.

Sidgel, Bamdev (*The Kathmandu Post*, 19th March, 1999) in the article entitled 'Foreign Investment: An Overview' has dealt with the investment climate of contemporary Nepal in brief. He has stressed on some of vital hindrances of FDI promotion in Nepal, which has weakened the effectiveness of the various policy-incentives offered to the foreign investors. In his opinion, land-lockedness, greater risks in the priority area, uncertainty due to frequent changes in the government and their policies and priorities, complicated bureaucracy, inefficient and lethargic administrative apparatus, a small domestic consumer market, low purchasing power of the people and deteriorating socio-economic condition have badly affected further opportunities.

Mathema, Sushil R (*The Kathmandu Post*, 14 the July, 1999) in the article entitled 'FDI Lacuna in Nepal' has figured out some of the core impediments in attracting FDI inflow to Nepal. He has mentioned (i)availability of location bound resources or assets; (ii) size of market and (iii) cost advantages in production as the three main economic determinants for the location of FDI in Nepal. Nepal assumes the third option having relatively cheap and large labor-force as the most augmenting factor that brings up cost advantage to FDI settlements in the country. On the other hand, Nepal's policy on FDI has not focused much towards ensuring optimal allocation of resources. With the chronical problem of instability in the government and its policies along with inefficiency of the bureaucratic set-up, the country is virtually lacking zeal towards identifying potential areas of comparative advantage and effective skill development policies. Lastly, he suggests that there is a strong need to modulate development strategy to attract FDI in the recent identified areas such as tourism and hydropower, intensifying efforts to provide other potential commodities and services that can serve a huge market demand in India.

Pradhan, StalinMan in the article entitled 'Baiddeshik Lagani Ka Kura' (The Matter of Foreign Investment) in *the Economic Post*, a Nepali national weekly (22 Feb, 2006) has asserted that the political instability is a prime hindrance in flourishment of FDI in Nepal. The advised measures are: removal of double taxation in dividends; abolishment of taxes and fees levied on export promotion firms; establishment of Export Processing Zones (EPZs); Special Economic Zones (SEZs); timely improvement in the Labor Act, stress on World Trade Organization (WTO) commitments, establishment of high level investment board to resolve the problems of foreign investors.

Finally, after reviewing some of the relevant literature on FDI in Nepal, this study aims at the analysis of FDI in general and FDI in the Service Sector in particular. However, not a specific study on the FDI in the Service Sector in Nepal was found.

CHAPTER III
RESEARCH METHODOLOGY

3.1 Nature of Research Design

In line with the objectives set forth by the research and the method of collection, the nature of research design employed in the present study is descriptive and analytical.

3.2 Sources of Data Collection

The study entirely rests upon secondary data. The data were assembled from offficial, unofficial and electronic sources, which mainly include Department of Industry (DoI), Ministry of Industry, Commerce and Supplies (MoICS), TU Central Library, Federation of Nepalese Chambers of Commerce (FNCCI), Ministry of Finance (MoF), Centre for Economic Development and Administration (CEDA), Central Bureau of Statistics (CBS), various public libraries, the websites of various global and national institutions like- WTO, IMF, UNCTAD, NRB and other academic/educational websites.

3.3 Procedures of Data Collection

As regards to the procedures of data collection, the researcher collected the unpublished data from DoI, while the published data were gathered through journals, books by the experts, articles publised in the national and international newpapers and the informations posted in the websites of various organizations.

3.4 Data Processing Procedures

Having collected all the necessary data, they were divided under differents headings and were later tabulated to make them compatible with the techniques of stastistical method and the requirements of the study. A general scientific calculator was used in calculating the data.

3.5 Analysis of Data

The tabulated data have been analyzed and interpreted with the aid of different statistical tools such as- pie chart, bar diagram, averages and percentages. The technique of Simple Regression Model, widely used for forecasting future trend, have been applied in the both cases- the overall FDI and the FDI in the Service Sector. The model fitted in the analysis of overall FDI is as follows:

$$\mathbf{F = a + bT}$$

[Where, F = Overall FDI in billion Rs.,

T = Time Periods: 0,1,2,3, ..., 16., a & b = parameters]

And

$$\mathbf{F_s = c + dT}$$

[Where, F_s = FDI in the Service Sector in million,

T = Time Periods: 0,1,2,3,..., 16., c & d = parameters.]

With the aid of the above-mentioned statistical tools along with a Simple Regression Model to analyze the data, some recommendations at the end have been advanced for the promotion of FDI in the Service Sector in Nepal.

CHAPTER IV

THEORETICAL AND HISTORICAL ASPECTS OF FDI

4.1 Theoretical Aspect of FDI

This section attempts to present the theoretical aspects of FDI covering the concept, definitions, types, theories and determinants of FDI.

4.1.1 Concept and meaning of FDI

Investment, in economics, refers to the spending made in an economic activity for the purpose of earning profits or returns. Unlike the spending in consumption, investment is aimed at creating more and more returns. Hence, investment has a close link with the sphere of production among the broadly defined areas of economics viz. consumption, production, distribution, exchange, and public finance.

Investment, in general, covers-portfolio investment or financial (indirect) investment and physical or real (direct) investment. The former is defined as expenditure on the purchase of financial securities such as stocks and shares, which is undertaken by persons, firms and financial institutions in the anticipation of earning a return in the form of interest or dividends or an appreciation in the capital value of the securities. Contrary to this, capital expenditure on the purchase of physical assets such as plants machinery and equipment (fixed capital) and stocks (working capital) in the hope of earning profits or returns is known as physical or real investment.

In economic analysis, the term 'investment' relates specifically to physical investment. Physical investment creates new assets thereby adding to the firm's productive capacity in micro perspectives, whereas financial investment only transfers the ownership of existing assets from one person or institution to another.

In macro perspectives, investment requires an amount of current consumption be foregone (i.e. saved) so as to release the resources to finance it. Investment expenditure, on the other hand, is a component of aggregate demand and an injection into the circular flow of national income. In national income analysis, investment in the provision of social products such as roads, hospitals and schools undertaken by the government is counted as part of government expenditure. Thus, investment expenditure is normally defined as that consisting only of private sector investment spending.

Investment can be classified into gross and net investment- the former being the total amount of investment that is undertaken in an economy over a specified period of time (commonly one year) and the latter being gross investment less replacement investment or capital consumption which is necessary to replace that part of the economy's existing capital stock which is used up in producing this year's output.

When it comes to the national level economy, investment can simply be splited into domestic investment and foreign investment. Domestic investment, on the whole, denotes investments made by the entrepreneurs and or commercial institutions within the territory. Foreign investment, on the other, refers to any investment by domestic residents (individuals, companies and financial institutions) in the acquisition of overseas physical assets and financial securities. In other words, foreign investment refers to any investment in another country which is carried out by private companies or individuals as opposed to government aid.

As investment is of two forms: real/direct/physical investment and portfolio/indirect/financial, foreign investment is also the same: foreign portfolio investment (FPI) and foreign direct investment (FDI). In this connection, FPI is said to have taken place when a foreigner and/or institution invest on financial assets of a home country. Unlike in FDI, it does not assume control over the management of the invested (economic) entity.

4.1.2 Definition of FDI

Many scholars as well as international economic and/or commercial institutions have frequently made studies on FDI. Unlike in other definitions of economic terms, there is generally a common understanding in case of FDI. However, due to unavailability of reference books in sufficient number, the help of websites and links is sought. Some of the widely-recognized and succinct definitions are as follows-

WTO (1996) indicates that 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. The management dimension is what distinguishes FDI from portfolio investment in foreign stocks, bonds and other financial investments. Indeed, 95 percent of FDI consists of transactions involving multinationals and their affiliates/subsidiaries. In short, FDI comprises of three components:

(a) New equity from the parent country in the home country to the subsidiary in the host country.
(b) Reinvested profits of the subsidiary and
(c) Long and short term net loans from the parents to the subsidiary.

(Source: www. southcentre.org/pub/fdi/toc.htm)

Any investment in productive assets by a company incorporated in a foreign country as opposed to investments in shares of local companies by foreign entities is known as FDI. It is an important feature of the globalized economic system of the day. *(www.economicswedinstitutes.org/glossary/fdi.htm)*

In another definition, direct investment means that the concerns of the investing country exercise *de facto* or *de jure* control over the assets created in the capital importing country by means of investment. Direct investment may take many forms:

1. The formation in the capital investing country of a subsidiary of a company of the investing country.
2. The formation of a concern in which a company of the investing country has a majority holding.

3. The formation in the capital importing country of a company financed exclusively by the present concern situated in the investing country.
4. Setting up a corporation in the investing country for the specific purpose of operating in the other country by the nationals of the investing country. Such companies or concerns are known as Transnational Companies (TNCs) or Multinational Corporation (MNCs).

Viewed from different perspective, FDI could be defined as equity investment of MNCs in the host countries. Around 35,000 MNCs are operating around the world along with 1, 50,000 foreign affiliates. They manage FDI and have become the driving force of the international economy.

FDI in its classic definition is defined as a company from one country making a physical investment into building a factory in another country. The direct investment in buildings, machinery and equipments in contrast with making a portfolio investment which is considered as an indirect investment. In recent years, given rapid growth and change in global investment patterns, the definition has been broadened to include the acquisition of a lasting management interest in a company or enterprise outside the investing firm's home country. As such, it may take many forms, such as a direct acquisition of a foreign firm, contraction of a faculty or investment in a joint venture or strategic alliance with a local firm with attendant impact of technology, licensing of intellectual property etc.

(source:www.going-global.com/articles/understanding_foreign_ investment.htm)

4.1.3 Misconceptions about What FDI is:

1. FDI does not necessarily imply control of the enterprise as only a 10 percent ownership is required to establish a direct investment relationship.
2. FDI does not comprise a 10 percent ownership (or more) by a group of 'unrelated' investors domiciled in the same foreign economy. FDI involves only one investor or a related group of investors.

3. FDI is not based on the nationality or citizenship of the direct investor. FDI is based on residency.
4. Borrowings from unrelated parties abroad that are guaranteed by direct investors are not FDI

(www.imf.org/np/sta/fdi/eng/2003/02903.pdf)

4.1.4 Types of FDI

FDI, in theory is of two types as per the nature of investment:

1. **Greenfield FDI**

   The FDI, which is made in setting up a new firm in the home country by host country firm/entrepreneurs, said to be Greenfield FDI. This form is an initial form of FDI.

2. **Acquisition and Mergers**

   With the passing of time, the form and type of FDI has got varied. In the same way, buying of a local firm or investing in a local firm by foreigners is known as Acquisition and Mergers. This type of FDI has been gaining ground now-a-days.

4.1.5 Theories on Foreign Investment

Numerous attempts have been made so far by the economists to formulate a theory capable enough to explain the phenomena of international investments. A brief outline of the important general theories in this direction is given as following:

1. Theory of Capital Movement

This theory is evolved by the earliest economic theoreticians, who assumed the classical philosophy upholding the existence of a perfectly competitive economy, according to which foreign investments are nothing but a form of factor movement to take advantage of different profits. The essence is that foreign investments constantly flows across the world in the want of greater returns in the same manner other factors of production do.

Charles Kindlerger, a noted economist, has made clear the validity of this theory from the observation that under the ideal state of perfect competition, foreign (direct) investment would not occur.

2. Market Imperfection Theory

Among the market imperfection approaches to the explanation of foreign investments, the Monopolistic Advantage Theory is propounded by Stephen lately in 1960. This theory forwards the argument that FDI occurs largely in oligopolistic industries rather than in industries operating under/near perfect competition. In this regard, the suggestion by Hymer is noteworthy which states that the decision of a firm to invest in foreign markets is based on certain advantages the firm possesses over the local native firm in the foreign land. Such advantages may include economies of scales, superior and strategic technology or skills in the field of management, production, marketing, finance and so on.

Kindlerger is also of the view that market imperfection is the basis of foreign investment, as opposed to perfect competition. Even if this theory has enjoyed a wide applause in the field of economics, the first and the foremost, it remains mute on some critical questions related to foreign investment, for instance, why does a firm show preference of foreign investment over other alternatives of market entry modes like exporting, licensing, franching, etc?

3. Internalization Theory

Developed as a logical extension of the market imperfection theory, internalization theory suggests that foreign investments results from the decision of a firm to internalize a superior knowledge. In simple terms, foreign investments made by a firm arise from the firm's intent to retain the knowledge within itself to maintain the comparative edge. Let's take an example-- if a firm concludes to externalize its know-how by awarding license to a foreign firm, the firm (or licensor) does not make any foreign investment in this sense. Contrary to this, if the same firm decides to internalize, it may invest abroad in production facilities. In short, *modus operandi* of internalization includes formal ways like secrecy, family networks *et al.*

4. Appropriability Theory

The Appropriability Theory concludes that any foreign investments by a firm is dependent upon the firm's capacity to appropriate (i.e. keep for its exclusive use) the benefits guaranteed by a technology it has generated. Provided that this condition is not met, the firm would not be able to bear the research and development. That is the reason MNCs always tend to specialize in advancing new technology which are transmitted efficiently via their internal channels.

It goes without saying that the Appropriability Theory is similar to the internalization theory in terms of creating an internal market (internal channel) for exploiting the firm's specific advantages.

5. Location-Specific Advantage Theory

The Location-specific Advantage Theory affirms that foreign investment is, to a large extent, induced by certain location-specific advantages an investing firm manages to enjoy.

As is explained by Hood and Young, there are four factors pertinent to the location-specific theories which are as follows:

i. Labor Costs
ii. Marketing Factors: (comprising market size, market growth, stage of development and extent of local competition)
iii. Trade Barriers
iv. Government Policies.

The above-mentioned factors have, no doubt, very significant bearing upon venturing any foreign investment. However, there are also other factors, for example cultural factors which influence foreign investments. Furthermore, not labor costs alone but the total costs in most cases are importantly taken into consideration.

6. International Product Life Cycle Theory

Propounded by Ramond Vernon and Lewis T. Wells, the theory takes into consideration the chain of the production process (es) across countries, any product has to undergo before coming to the final shape and size. The production of a product shifts to various categories of countries through the different stages of product life cycle.

According to this theory, a new product is first manufactured and marketed in an advanced country (like the US) thanks to favorable factors like large domestic market, entrepreneurship and ease of organizing production etc. It is then exported to other developed markets. As competition mounts in these markets, manufacturing facilities are established there to cater those markets and also to export to the developing countries.

As the product becomes standardized and competition further intensifies, manufacturing facilities are established in developing countries due to lower production costs and other reasons. The developed country markets may also be serviced by exports from the production units in the developing countries. This theory turns out to be true of several products like television sets, computers, motors etc.

7. Eclectic Theory

John Dunning, on combining the postulates of some of the earlier theories, has formulated a general theory of international investment. The theory argues that foreign investments by MNCs results from three comparative advantages which they happen to exploit:

i. Firm-specific advantages
ii. Internalizational advantages
iii. Location-specific advantages.

Firm-specific advantages result from the tangible as well as intangible resources held exclusively, at least, temporarily by the firm and which offer firms comparative advantages over other firms. However, the firm-specific advantages would not result in foreign investments unless the firm internalizes these advantages. Even when a firm internalizes its exclusive resource, it may be able to serve a foreign market without foreign investment (for example by exporting). Hence, for the production to take place in the foreign country, it should possess some location-specific advantages.

The theory also suffers from a deficiency that it does not explain the foreign investment for acquisitions which have become a very important route to internationalization now-a-days.

8. Other Theories

As maintained by Knickerbocker's Theory of Oligopolistic Reaction and Multinational Enterprise, when one firm, especially the leader in an oligopolistic industry entered a market, other firms in the industry followed by a defensive strategy i.e. to defend their market-share from being taken away by the initial investor with the advantage of local production)

Graham noted that there was a tendency for across oligopolistic industries. When American firms invested in Europe and the European firms retaliated by investing in America and vice verses. This was mostly retaliatory strategy.

On the other hand, there are also other reasons for investment like following the customer (for instance, the Japanese automobile ancillary firms to foreign markets) and seeking knowledge (for example, Japanese and European investment in Silicon Valley). These theories at best explain the reasons for some of the foreign investments only.

4.1.6 Host Country Determinants of FDI

Inward FDI is dependent on a host of economic and non-economic factors. Economists have explained them in their own way which has made the whole analysis of determinants of inward FDI rather a cumbersome job. However, some of the prominent views and perspectives are aimed to deal with in the following.

Traditional view:

To begin with, for analytical convenience, the traditional economic determinants of FDI are divided into three groups, in which each of them reflects the principal motivations of investing in a foreign country: *resource seeking, market seeking* and *efficiency seeking.*

Historically, the most important motivation of FDI has been the exploitation of natural resources, which can be crystallized from the FDI by European, United States and Japanese firms in the nineteenth century to secure an economic and reusable source of minerals, primary products for the then emerging industrializing nations of Europe and North America. Although the post-Second World War period, particularly since the 1960 to 1970, witnessed a decline in the share of natural resources in the FDI, the availability of natural resources is still a major determinant of FDI and continues to offer important possibilities for inward investment in resource-rich countries.

Another important traditional determinant of FDI has been market-seeking. It is evident from the facts and figures that the largest market in the world, i.e. the US is the largest recipient of FDI, followed by China, a huge market by the size of the economy, population and very high economic growth rates. The lion's share of FDI flows to the developing countries, more specifically to those with larger markets with comparatively good infrastructure and political stability in general.

The third important motivation of FDI is efficiency seeking. A low cost of production, deriving mostly from cheap labor is the prime driving force of many FDIs in developing countries. Furthermore, Export Processing Zones (EPZs) have been established by developing countries mostly in a bid to take advantage of the efficiency seeking.

It is also to be noted that the existence of any of the above-mentioned three determinants alone need not attract FDI. A country even if rich in natural resources or with abundance of cheap labor, FDI would not take place in the absence of required infrastructural facilities to run the industry trade.

Modern View:

The modern view on the host-country determinants of FDI is broader than that of traditional one. It includes several other factors like the political environment, government policies, bureaucratic culture, and social climate and so on.

In view of John D. Sullivan in *Prospering in the Global Economy* (Economic Reforms Today, No.1, 2001), the prime host country determinants of FDI are as follows:

i. Stable, predictable macroeconomic policy.
ii. An effective and honest government.
iii. A large and growing market.
iv. Freedom of activity in the market.
v. Minimal government regulation.
vi. Property rights and protection
vii. Reliable infrastructure.
viii. Availability of high quality factors of production.
ix. A strong local currency.
x. The ability to remit profits, dividends and interests.
xi. A favorable tax climate.
xii. Freedom to operate between markets.

However, the determinants of inward FDI includes social and economic factors as stated in UNCTAD, World Investment Report 1998, which is presented in the following box:

Box 1
Host Country Determinants of FDI*

1. Policy Framework for FDI:

- Economic, political and social stability.
- Rules regarding entry and operations.
- Standards of treatments of foreign affiliates.
- Policies on functioning and structure of markets. (Especially composition and M&A policies)
- International agreement on FDI.
- Privatization policy.
- Trade policy (tariff and NTBs) and coherence of FDI and trade policies.
- Tax policy.

2. Business Facilitation

- Investment promotion (including image building and investment generating activities and investment facilitation services)
- Investment incentives.
- Hassle costs (relates to corruption, administrative efficiency etc.)
- Social amenities (bilingual schools, quality of life etc.)
- After investment services.

3. Economic Determinants:

Type of FDI classified by Motives of TNCs	Principal economic determinants in host countries
A. Market seeking	Market size and percapita income Market growth Access to regional and global markets Country-specific consumer preferences. Structure of market.
B. Resource-seeking	Raw materials. Low-cost unskilled labor. Skilled labor. Technological innovatory and Other created assets (e.g. brand names) Including as embodied in Individuals, firms and clusters. Physical infrastructures. (E.g. posts, roads, power, telecommunications)
C. Efficiency-seeking	Cost of resource and assets listed under B adjusted for productivity for labor resources. Other input costs e.g. transport and communication costs to/from and within host economy and cost of other intermediate products. Membership of a regional integration agreement conducive to establishment of regional corporate networks.

* Reproduced from UNCTAD, *World Investment Report, 1998.*

In a nut-shell, it can be summarized that the host country determinants of FDI is a complex issue comprising political, social and economic factors. On political front, the important factors are governance and democratic norms and values. Likewise, social factors can be peaceful functioning of social units, absence of hostility among any groups, sense of coexistence and people's 'foreigner-friendly' extrovert attitude. The most important of all, the economic factors are very important determinants that include a stable economy with favorable macro variables, resources abundance, existence of areas of comparative advantage with cheap factors of production, large market, access to regional and global market, government incentives in terms of profit and dividend repatriation, tax concessions to mention just a few.

4.1.7 Multinational Corporations (MNCs): History and Happening

MNCs are also known as International Corporation, Transnational Corporations (TNCs), Multinational Enterprises (MNEs), Global Corporation (or firm, company, enterprise) etc. As have been stated earlier, MNCs are the prime feature of global economic system of the present day, which manage the FDI across the globe. The MNCs account for a significant share of the world's industrial investment, production and trade. The dynamics of the business environment fostered by the drastic political changes in the erstwhile communist and socialist countries and economic liberalization across the world has enormously extended the opportunities for MNCs. MNCs have been growing rapidly over the years in developed as well as developing countries. These phenomena have simplified the global flow of FDI. However, it follows some of the criteria often used to define the MNCs.

Definition by size. The term MNC indicates bigness. The dimension of bigness such as market value, sales, profits and return on equity will have varying results. Though this criteria normally excludes the firms below certain size from the definition of multinational; the extent of internationalization is not necessarily dependent on the size, a small firm may be much more global than larger ones.

Definition by structure. An MNC possesses at least two significant dimensions, performance and behavior. Structural requirements for definition, as an MNC include the number of countries in which the firm does business and the citizenship of corporate owners and top managers.

Definition by performance. The definition by this criterion takes into consideration the factors such as earning, sales and assets as the measuring rod to gauge the extent of the commitment of corporate resources to foreign operations and the amount of rewards from that commitment.

Definition by behavior. Majorly focused on behavioral features of top management, as a measure of multinationalisation, this criterion is somewhat abstract. Globalization basically is a mind-set that reflects the global orientation of the company. However, the index of internationalization includes:

i) The ratio of foreign sales to total sales.
ii) The ratio of foreign assets to total assets.
iii) Proportion of overseas subsidiaries to total subsidiaries.
iv) Top manager's international experience.
v) Psychic dispersion of international operations.

Some Popular Definitions:

According to an ILO report, the essential nature of the multinational enterprise lies in the fact that its managerial headquarters are located in one country (referred to, for convenience, as the 'home country'), while the enterprise carries out operations in a number of other countries as well (host country). Obviously, what is meant is a cooperation that controls production facilities in more than one country. Such facilities having been acquired through the process of FDI. The point is that the firms participating in international business, however large they may be, solely by exporting or by licensing technology are not multinational enterprises.

Among the various other benchmarks used to define 'multinationality' are that the company in question must:

i) Produce (rather than just distribute) abroad as well as in the headquarters' country.
ii) Operate in a certain minimum number of nations.
iii) Derive some minimum percentage of its income from foreign operations (e.g. 25 percentages).
iv) Have a certain minimum ratio of foreign to total number of employers or of foreign total value of assets.
v) Possess a management team with geocentric orientations.
vi) Directly control foreign investment (as opposed to simply to holding shares in foreign companies)

As per the World Investment Report, the definition of the terms Transnational Corporation (used to refer the same thing as MNC and similar terms) is incorporated as well as unincorporated enterprises comprising parent enterprises and their foreign affiliates. A parent enterprise is deemed as an enterprise that controls assets of other entities in countries other than its home country, usually by owning a certain equity capital state. An equity capital stake of 10 percentage or more of the ordinary shares or voting power for an incorporated enterprise, or its equivalent for unincorporated enterprises, is normally considered as a threshold for the control of assets. In some countries such as Germany and United Kingdom, the threshold is at stake of 20 percentage or more.

The World Investment Report of 1999 further explains that TNCs establish under the common governance of their headquarters, international production system in which factors of production move, to a greater or lesser extent, among units located in different countries. These systems increasingly cover a variety of activities ranging from research and development (R&D) to manufacturing to service functions such as accounting, advertising, marketing and training dispersed over host-country locations and integrated to produce final goods and services, they are also increasingly being established, especially in developed countries, through mergers between existing firms from others.

Once internally dispersed production units under common governance are established, mobile and location bound factors of production to which a TNC has access in home and host countries (and sometime even third countries) are combined in each unit in ways and for production that contribute the most to the firm's economic and strategic objectives. From the perspectives of factor-use as distinct from that of location as host or home country for enterprises engaged in international production, all of the production that take place in these TNC production systems (in parent firms or home country units as well as foreign affiliates or host country units) constitutes international production.

To reassure the extent of transnationalisation of firms, the World Investment Report has been constructing a transnationality index, which is the average of these ratios: (a) Foreign assets/total assets (b) Foreign sales/total sales (c) Foreign Employment/total Employment. Hence, the transnationality index captures the foreign dimension of the overall activities of a firm.

4.1.8 Reasons for Companies Going Global

Companies normally go 'global' for six primary reasons:

1. To broaden their markets. After the company has saturated its home market, growth opportunities are often better in foreign markets.

2. To seek raw materials. Many of the existing MNCs began their international operations because raw materials were located abroad.

3. To seek new technology. Because no single nation holds a commanding advantage in all technologies, companies are scouring the globe for leading scientific and design ideas.

4. To seek production efficiency. Still other firms have moved their manufacturing facilities overseas to take advantage of cheaper production costs in low cost countries.

5. To avoid political and regulatory hurdles. Firms can avoid political and regulatory hurdles by moving production to other countries.

6. To diversify. Firms go international so that they can diversify, and consequently, cushion the impact of adverse economic trends in any single country.

4.1.9 Pros and Cons of FDI

Modern conception regarding the role of FDI inflow is found to be somewhat positive. As a result, all the countries, whether developed or developing, have focused their attention in attracting larger amount of FDI inflow by incorporating FDI-friendly policies in their national economic priorities. However, there is still a necessity for cautious investigation to minimize the possible hazards that FDI could cause especially in a developing economy. Keeping this in mind, an attempt is to be made to find out the pros and cons of FDI inflow with special reference to a developing country.

Pros

The first and the foremost, the need for FDI felt by the developing countries is for the fulfillment of gaps- saving and foreign gaps among others, prevailing in the economy as long-standing problems. The developing economy needs a huge amount of capital to undertake the long-term development projects along with maintaining the regular public expenditure. Moreover, the amount of foreign grants has been declining over the years making the option to go for FDI on the part of developing countries to meet the aforesaid objectives.

Secondly, FDI is, no doubt, an important productive factor inputs. It brings in finance; managerial, administrative and technical personnels; new technology. Moreover, it emphasizes on research and innovations.

Thirdly, FDI has another beauty of inducing indigenous enterprise or business community, directly by way of fostering local enterprise with 3 M: Men, Material and Money and by imparting training and experience to its personnel; indirectly by creating demand for ancillary or subsidiary services (like transport and training agents) which are uneconomical for private foreign enterprise to provide.

Fourthly, FDI inflows helps the developing country in it's endeavor to increase capital formation, national output and employment opportunities, thereby reducing the chronic poverty. Consequently, it helps in strengthening the social harmony when there is absence of sufficient capital, broader production frontier and vast unemployment.

Fifthly, FDI is always motivated by profits; the greater the profits, the greater the FDI. When FDI enters in a country, it helps in expansion, modernization and development of related industries through ploughing back a part of profits.

Sixthly, developing country is always making every effort in the pursuit of industrialization. For this purpose, FDI is the only reliable and feasible way available in the hands of a developing country, which provides the necessary resources.

Seventhly, FDI inflows are always welcome in the developing country as it yields greater revenue to the government, which can be utilized in much-needed social sectors.

Eighthly, an important cause for inviting greater FDI is due to the fact that it gives impetus to raise productivity of the sectors via improved equipments and technology and skilled man-power, which automatically results in a rise in real wages.

Ninethly, greater FDI inflow improves the existing unfavorable Balance of Payment (BoP) situation by providing the developing country with the adequate capital to sustain the imports for long-run development projects and current consumption.

Tenthly, as FDI flows into the country, it has reinforcing effects. This means that it is self-spreading. Greater FDI in one sector of the economy leads to greater FDI in the another.

Finally, when FDI funded projects operates in an economy, it increases the competition to a large extent. Competition makes the producers impelled to adopt new method of production. Now-a-days, increased level of competition has taught the giant MNCs to spend an enormous chunk of capital in Research and Development (R & D), which has become a 'business culture' of MNCs. Competition means goods at lower prices or more goods at the same prices. That is to say-- competition ultimately benefits the consumers. On the other hand, with the increase of MNCs, the concept of consumerism evolves, which is for the welfare of the common people.

Cons

It goes without saying that FDI is all important for a developing country as well as developed one. However, it is not that FDI has no evils. Actually, it has got some bad characters also which might turn out to be harmful and could sometimes play as a hindrance to development of the economy. So, the following are some of the black-spots of FDI especially for a developing country.

Firstly, the argument put forward by the antagonists of FDI is that FDI is not in line with the objectives and conditions of a developing economy. It has always a fear of misallocation of resources with the FDI. The government has to spend precious capital left over to itself for the promotion of FDI, which could otherwise be utilized in the sectors with higher returns in economic and social perspectives.

Secondly, as the level of FDI mounts, it might cause a serious Balance of Payment problem (though of temporary nature) and this could be a lasting economic ill to the economy.

Thirdly, FDI inflows have another disastrous nature of causing income inequalities within the economy. The harmfulness of inequalities in income distribution may simply outweigh the benefits of FDI due to serious social, economic and political implications.

Fourthly, the nature of MNCs is such that they can easily put the domestic business sector into trouble by means of sophisticated and ultra-expensive equipments and overly-qualified manpower. Though the rise in competition is deemed to be good, but when it discourages the local enterprises, it would be very hard to recoup.

Fifthly, another hazard of FDI is that it perpetuates the counterproductive consumption patterns, which is very bad to the economy. This lessens the valuable resources by skyrocketing the imports of luxury items.

Sixthly, the method of production that the FDI funded MNCs make use of is faulty in the context of developing country. They encourage capital-intensive technique of production which is utterly inappropriate due to the existence of mass unemployment. Moreover, the majority of the labor-force consists of unskilled and semi-skilled labor which calls for labor-intensive production technique.

Seventhly, heavy influx of FDI curtails the autonomy of domestic economy. The national economy becomes highly vulnerable to external shocks. The fiscal and monetary health of the economy depends on the international business cycle. This may lead to 'post-modern imperialism' that means that the country becomes dependent on the other country in settling the economic matters losing control in oneself.

Finally, the possible political setbacks may be cited as another fatal impact of FDI, because the huge amount of FDI may bring changes in the government of the developing country.

4.2 Historical Aspects of FDI

This section has been divided under two sub-headings: FDI in the Global context and in the Nepalese context for precision and simplicity.

4.2.1 FDI in the Global Context

It would be very hard to know exactly when FDI started in the world. However, if we look at the history of MNCs, this could be said to have begun with the founding of the British East India Company in 1600. But the data are missing regarding global FDI; however, since the end of World War II, there has been a rapid growth of such companies that accelerated trend of economic liberalization and globalization.

However, the FDI across the developed countries had started much earlier. The concept of economic liberalization and globalization took centre stage with the beginning of 1970s, prior to which many developing countries felt the bringing of Multinational Enterprises into the country as a serious threat to national sovereignty. After 1970s, some vital changes in the traditional concept of FDI resulted in the curtailment of the role of state and the rise of private investment. But until 1980, most of developing countries considered FDI with great wariness. In the meantime, developing countries focused in their long-pending journey to infrastructure development and poverty alleviation for which the internal resource could not manage. Consequently, the necessity of foreign aid was felt and the flow of foreign aid initially in the form of grants to these countries started to mount. But later on, the developing countries were under a constant fear of falling into a 'serious debt trap' due to that foreign aid was in the form of loans. Donor agencies further reduced to the amount of grants arguing that grants were not property utilized. The rising amount of foreign loans (than grants), emphasis of donors (as agencies or countries) in newly-established countries and the ever-growing need of investment in the economy made the developing countries to pick FDI as an alternative. Developing countries have been feeling a sense of relief from any burden of loans after they adopted the FDI-friendly policy. This is how FDI has become a global phenomenon now-a-days.

Global FDI Inflow

The following table exhibits the present status of the different countries in the world in case of FDI:

Table 4.1
FDI Inflow, by region and economy 2002-2004

(Millions of dollars)

Destination	FDI Inflow		
	2002	2003	20004
World	716128 (100%)	632599 (100%)	648146 (100%)
Developed Economies	547778 (76.49%)	442157 (69.90%)	380022 (58.36%)
Europe	427560 (59.76%)	359369 (56.87%)	223400 (34.47%)
European Union	420433 (58.71%)	338678 (53.54%)	216440 (33.39%)
Other Developed Europe (Gibraltar, Iceland, Norway & Switzerland)	7127 (1.00%)	20691 (3.27%)	6961 (1.07%)
North America (Canada, USA)	92838 (12.96%)	63183 (9.99%)	102152 (15.76%)
Other Developed Economies (Australia, Israel, Japan, New Zealand)	27379 (3.82%)	19604 (3.10%)	54469 (8.40%)
Developing Economies	155528 (21.72%)	166337 (26.29%)	233227 (35.98%)
Africa (Latin America & the Caribbean)	50492 (0.07%)	46908 (7.42%)	67526 (10.42%)
Asia & Oceania	92042 (12.85%)	101424 (16.03%)	147611 (22.77%)
Asia	92009 (12.85%)	101278 (16.01%)	147545 (22.76%)
East Asia	67282 (9.40%)	72.60 (11.39%)	105037 (16.21%)
South Asia	4528 (0.63%)	5331 (0.84%)	7005 (1.08%)
South East Asia	14507 (1.96%)	17364 (2.74%)	25662 (3.96%)
Oceania	33 (0.005%)	146 (0.02%)	67 (0.01%)
Least Developed Countries	6327 (0.88%)	10357 (1.64%)	10702 (1.65%)
All Developing Countries (excluding China)	102785 (14.34%)	112832 (17.84%)	172597 (26.36%)

Source: UNCTAD, The World Investment Report 2005, FDI/TNC database (www. unctad/fdistatistics)

Note: Data on FDI inflows in China as reported by China's State Administration of Foreign Exchange are the following: US$ 49308 million (6.89 percent of the World's Total FDI Inflow) for 2002, US$ 47077 (7.44 percent of the World's Total FDI Inflow) million for 2003 and US$ 54936 million (8.48 percent of the World's Total FDI Inflow) for 2004.

The global FDI inflow in 2002 marked US$ 716.1 billion, which in 2003 became US$ 632.5 billion registering a decline of 11.6 percent. But in 2004, it rosed by 2.4 percent again reaching to US$ 648.1 billion. Out of the world's total FDI inflow, the developed economies soaked 76.5 percent in 2002 totalling US$ 547.7 billion, which in 2003, plunged into US$ 442.1 billon constituting 70 percent and reached US$ 380.0 billion (58.6 percent) following a sharp decline. On the other hand, the share of the developing countries was US$ 155.5 billion making up 21.7 percent of the World's total FDI inflow, which maounted to US$ 166.4 billion taking 26.3 percent. The share of developing countries in the World's FDI inflow being 0.88 percent in 2002, grew in 2004 reaching 1.6 percent which later in 2004 experienced a rise mounting 1.6 percent totalling US$ 10.7 billion. The performance of developing and least developed countries have shown a positive trend, which can offer a host of opportunities to these economies.

In case of Asia, it attracted US$ 92.0 billion making up 12.8 percent of the World's total FDI inflow in 2002, which witnessed a remarkable rise hitting 16.1 percent worth US$ 101.3 billion in 2003. In the year 2004, Asia received US$ 147.5 billion, making up 22.8 percent.

Likewise, South Asia absorbing 0.6 percent of the World's total FDI inflow worth US$ 4.5 billion in 2002 managed to attract 0.84 percent worth US$ 5.3 billion in 2003, which in 2004 received 1.08 percent worth US$ 7.0 billion. This indicates that the South Asian Countries have been receiving the increasing share of the World's total FDI inflow and are gaining ground as a lucrative FDI destination. This has shown the growing prospects of FDI inflow in the region.

FDI Inflow in South Asia (SA)

The comparative performance of the SA countries in terms of attracting FDI inflow can be analyzed by means of the following table:

Table 4.2

FDI Inflows in the South Asia (SA), 2002-2004

(Millions of dollars)

Region/economy	FDI Inflow		
	2002	2003	20004
South Asia	4528 (100%)	5331 (100%)	7005 (100%)
Afganistan	1 (0.02%)	2 (0.04%)	1 (0.01%)
Bangladesh	52 (1.15%)	268 (5.03%)	460 (6.57%)
Bhutan	-	1 (0.02%)	1 (0.01%)
India	3449 (76.17%)	4269 (80.08%)	5335 (76.16%)
Maldives	12 (0.27%)	14 (0.26%)	13 (0.19%)
Nepal	-6 (0.13%)	15 (0.28%)	10 (0.14%)
Pakistan	823 (18.18%)	534 (10.02%)	952 (13.59%)
Srilanka	197 (4.35%)	229 (4.30%)	233 (3.33%)

Source: UNCTAD, The World Investment Report 2005, FDI/TNC database (www. unctad/fdistatistics)

India received the highest portion of the total FDI inflow in the region with US$ 3449 million (76.2 percent) in 2002, US$ 4269 million (80.1percent) in 2003 and US$ 5335 (76.2 percent) in 2004. Pakistan attracted US$ 823 million (18.18 percent) in 2002, US$ 534 million (10.02 percent) in 2003 and US$ 952 million (13.39 percent) in 2004. However, the relative performance of Nepal in attracting FDI into the country has been found to be disproportionate. Nepal attracted US$ 6 million (0.13 percent) in 2002, US$ 15 million in (0.28 percent) in 2003 and US$ 10 million (0.14 percent). Nepal ranks at the position just ahead of Afganistan and Bhutan.

Global FDI Stock

The following table provides some useful information regarding the distribution of the total global FDI stock across the world:

Table 4.3
FDI Stock, by region and economy, 1990-2004 (estimate)

(Millions of dollars)

Region/economy	FDI Inward Stock		
	1990	2000	2004
World	1768589	5780846	8895279
Developed Economies	140441	3976356	6469832
Europe	800751	2292922	4258547
European Union	753707	2174834	4023935
Other Developed Europe (Gibraltar, Iceland, Norway & Switzerland)	47045	118088	234612
North America (Canada, USA)	507754	1469583	1777678
Other Developed Economies (Australia, Israel, Japan, New Zealand)	95906	213852	433608
Developing Economies	364057	1734543	2225994
Africa	59906	151246	219277
Latin America & the Caribbean	118133	514246	723752
Asia & Oceania	186479	1068663	1282964
Asia	183849	1064078	1278608
East Asia	84065	707616	802657
South East Asia	63171	263365	323588
South Asia	19603	28706	52221
Afganistan	12[a]	17[a]	22[a]
Bangladesh	324[a]	2429	3433[a]
Bhutan	2[a]	12[a]	15[a]
India	16657[a]	17517	38676
Maldives	25[a]	119[a]	169[a]
Nepal	12[a]	97	135
Pakistan	1892	6919	7596[a]
Srilanka	679[a]	1596	2175[a]
Oceania	2630	4585	4356
Least Developed Countries	9444	38384	71953
China	20691[a]	193348	245467
All Developing Countries (excluding China)	343396	1541195	1980527

Source: *UNCTAD, The World Investment Report 2005, FDI/TNC database (www. unctad/fdistatistics), Note: a= estimated*

The global FDI Stock in 1990 marked US$ 1.76 trillion, which in 2000 became US$ 5.78 trillion growing more than three times. In 2004, the World FDI Stock hit US$ 8.89 trillion with 53.9 percent rise in that of 2000. The developed economies shared 79.41 percent of the World FDI Stock in 1990 totalling US$ 1.40 trillion, which in 2000 increased to US$ 3.98 trillion constituting 68.8 percent and reached US$ 6.47 trillion (72.7 percent) in 2004.

On the contrary, the share of the developing countries was US$ 336.05 billion making up 20.6 percent of the World FDI Stock in 1990, which rose by more than four times and became US$ 1.73 trillion. In 2004, it mounted to US$ 2.22 trillion which is 25.02 percent of the World FDI Stock.

Looking at Asia, it accounted for 10.40 percent of the World's total FDI Stock worth US$ 183.8 billion of FDI Stock, which bacame US$ 1.1 trillion in 2000 by more than five times. The FDI Stock in Asia marked US$ 1.27 trillion (14.37 percent) in 2004, rising by approximately 20 percent.

Likewise, SA acquired FDI Stock worth US$ 19.6 million making up 1.11 percent of the World's total FDI Stock, which grew by 1.5 times becoming US$ 28.7 billion (0.50 percent). The same amounted to US$ 55.2 billion (0.59 percent) in 2004, rising by more than 80 percent.

Among SA countries, India accounted for 84.97 percent of the total FDI Stock in the SA, worth US$ 16.6 billion in 1990, which became US$ 17.5 billion (61.02 percent) in 2000. In 2004, it rose by more than two times and reached US$ 38.6 (74.06 percent). In the same way, Nepal had US$ 1.2 million in 1990, which increased to 97million and became 135 million in 2004. The share of Nepal in the total FDI Stock in SA was 0.06 in 1990, 0.34 in 2000 and 0.26 in 2004 respectively.

4.2.2 FDI in India and China

In the present context, Nepal's two big neighboring countries, India and China have been emerging as attractive destination countries for FDI. Besides, these have been growing up as promising global economic powerhouses with the greater FDI inflow.

India has been making stunning performance in attracting FDI. Of the foreign investment companies established in India, 70 percent of companies have been earning profits and 12 percent operating under the condition of the *Breaking Even*. Sectors primarily as telecom, ports, airports, railways, roads, energy and construction development are said to have immense opportunities for FDI. India is expected to attract additional FDI with some extra incentive scheme that consists of tax incentives, custom duty facilities and Special Economic Zone (SEZ). According to the available data of 2004/05, FDI worth US $ 5536 million has entered India. The countries making highest FDI in India are Mauritius, USA and Netherlands.

In 2005, the volume of foreign funds attracted to India, which has become the country ranking second in the world, has surpassed that attracted into the US *(www.en.ce.cn/insight)*. The prime sectors that attracted FDI are manufacturing, Information Technology (IT), financial sector, and construction among others.

On the other hand, China adopted the national policy to attract FDI with the declaration of economic reform program in 1978 oriented toward liberal economic regime. Since then, China has been trying to attract more and more FDI in various sectors of the country. China has provided tax-holiday for two years after the invested company's profitable year commences and for additional next three years, 50 percent tax concessions. China had started to invite FDI in the coastal cities in the beginning. Later, China made the policy of 'Go West-- Enjoy Facilities' for the development of the western country side through greater FDI. At present, more than 500 of MNCs have already entered China. In fact, China has been the hubbub of foreign capital inflow for the last decade.

With a comparative view on the FDI since 2005, service industry, energy industry and its relevant sectors remain to be the hotspots of investment growth in China. At the same time, a lot of inland cities begin to become the targeted areas of FDI. As the Chinese government enhances the construction of new countryside, it is also possible for the countryside to attract more and more attention.

In recent years, FDI attracted to China which hit the historic height of US $ 60 billion in 2004, has witnessed a sustained growth. In 2005, the number of newly established foreign investment enterprises across China amounted to 44,001 with a year-on-year growth of 0.77 but the foreign investment actually used amounted to US $ 60.325 billion with a year-on-year decrease of 0.5 percent.

The transition period after the accession to the World Trade Organization (WTO) has further cut down doorsill for the Chinese market. The potentials to enjoy the largest growth rate of service and trade market are a comparative advantage for China to attract foreign investment. It is expected that during a rather long forthcoming period of time, service industry will remain as a field in the favor of FDI in China.

4.2.3 FDI in the Nepalese Context

As a matter of fact, the history of foreign investment in general is short and that of FDI is even shorter. The nation had previously adopted the restrictive policies which were gradually lifted with the passage of time realizing the change in global economic philosophy of the West and the productive role of foreign investment in the national economy.

Going back to the era of Prithivi Narayan Shah, under whose reign Nepal got united in the present form, foreign investors with their enterprises in any sector of the economy were not allowed to enter into the nation. This was the most rigid restrictive policy ever followed by the nation with the notion that the foreign enterprises would be economically hazardous and politically as 'foreign invasion'. However, the restrictive policy did not remain effective for long which came to an end as soon as the Rana regime (1846- 1950 AD) led by

Jang Bahadur Rana rose to power. The country had begun to establish 'friendly ties' with the economically and politically close neighboring countries.

With the passing of time, the need for industrialization was felt though lately. The nation initiated the industrialization drive with the set-up of Udyog Parishad (Council of Industry) in 1936 followed by the Nepal Company Act, 1936. The act had made few provisions for industrial enterprises or joint stock. In the year of 1936, the Biratnagar Jute Mill was established, which turned out to be the first joint stock public company in collaboration with some Indian entrepreneurs and local counterparts. This event marks an important insight to the ever valuable role of foreign investment in commencing the process of industrialization in the country. It is for sure that the process of industrialization would have been tardier in the absence of foreign investment.

Then came the World War II which spurted a massive demand for Nepalese Jute products yielding heavy amount of profits to the enterprises. Consequently, a large number of other joint venture industries with the Indian investors mushroomed. By the year 1945, there had been twenty joint stock companies that mostly concentrated in the production of handmade papers, soap, ceramic, furniture, mats, textiles and cigarettes and so on. The remarkable joint ventures included Morang Cottage Mills, Morang Sugar Mills, Raghupati Jute Mill, Juddha Match Factory in the district adjoining of Indian borders. Still at that time, there was no clear policy of the government in foreign investment.

The post-war period (1946-1959) witnessed the largest number of joint stock companies in Nepal but this event of development proved to be momentary. Most of them went out of existence ending a rosy development of joint stock industries. The reason behind this phenomena is possibly that the demand of the Nepalese goods were stimulated by mostly by the unstable conditions of post war years, when the then developed countries were engrossed in warfare. Moreover, the trade and transit disputes with India, which did ignore the transit agreement made by the two countries for five years, added insult to injuries. India presented itself in the hard times of Nepal as indifferent, though the former had remained the major trade partner of the country and country with a 'friendly ties'. Other causes responsible for the down-turn of the industries in the country were decline in the quality of products, mounted international competition and employment of traditional technique in the production process. These undesired and unprecedented events badly eroded the confidence of foreign investors to the maximum.

In the global context after the cassation of the World War II, the wave of globalization started to grip the West under its influence. Nepal did not stay aloof from the then global economic philosophy. Later in 1961, Industrial Enterprise Act, 1961 was promulgated, which clearly identified the scope and amount of foreign investment. The act set the limitation of foreign investment of Rs. 50,000 to Rs. 500,000 for medium scale and more than Rs 500,000 for large scale industry. The act set the minimum of Rs. 50,000 for any foreign investment project. The act allowed repatriation of capital and profits in the convertible foreign currency upto 10 and 25 percent respectively.

With the provision of foreign exchange for necessary machinery, spare parts, materials and for the remuneration of foreign technicians. The most important of all, the act guaranteed non-discriminatory behavior to foreign and domestic investors.

Nepal has placed greater emphasis in attracting FDI explicitly stating in the Sixth Plan (1980-1985). The Industrial Policy, 1981 made separate provisions for the matter of foreign investment. Among others is that industrial enterprises will be welcome on the ground of obtaining access to desirable technology, import substitution, expansion of export markets and higher employment opportunities. In the following year, the Foreign Investment and Technology Act 1982 were promulgated assuring that not a single foreign industry be nationalized. The act opened for foreign investors to buy majority of shares in 100 percent in large scale industries with more than Rs. 10 million investments in fixed assets.

Similarly in 1987, 100 percent ownership provision for foreign investors was allowed by the government which could be up to 90 percent of produces from their enterprises. Some modifications on procedures, such as 'the One Door Policy' were also announced to attract foreign investment.

After the restoration of multiparty democratic system in Nepal, the first elected government adopted the fresh policy measures in several economic spheres including new Industrial Policy 1992, Investment Policy 1992 and One Window Policy 1992 for speeding up the long-delayed process of industrialization through the mobilization of available local capital as well as attracting foreign investment and technology in the country.

Moreover, in November 1992, Nepal hosted the Nepal Investment Forum where government presented 115 viable projects' proposals. In the meantime, investors signed the Memorandum of Understanding (MoU) to set up various types of 119 new projects in Nepal and investment worth about US$ 900 million was committed.

In the year 1992, the Foreign Investment and Technology Transfer Act (FITTA) - 1992 and Industrial Enterprise Act (IEA) - 1992 were put into practices which are the extant paramount legislative acts that address private investment regime in Nepal. These acts are widely acclaimed as the most liberal and investment-friendly among the acts adopted by Nepal. The 100 percent equity investment was allowed for foreign investors in large and medium scale industries with more than Rs. 20 million fixed investment. Likewise, foreign investment less than Rs.20 million, only transfer of technology was allowed. In the same year, One Window Policy and Industrial Policy were also made.

The legislative moves taken by the government are found to be comprehensive and aimed to attract FDI providing an investment friendly atmosphere. The facilities provided by these acts ranges from facilities of foreign exchange currency and tax concessions to the settlement of disputes with the provision of arbitration of United Nations Commission on International Trade Law (UNCIRTAL). However, the full details about these acts will be dealt with in the following chapter separately.

Due to these efforts, by 1998, 420 foreign investment projects with NRs. 11,841 million had been found to be operating in Nepal providing employment to more than 60 thousand laborers. Most of the foreign investment for Nepal has been concentrated in the manufacturing sector, followed by tourism, service, agriculture, construction, energy, mines etc.

CHAPTER V
LEGAL FRAMEWORK OF FDI IN NEPAL

5.1 Background

The government has been working with might and main to attract FDI formulating a number of acts and policies making them favorable and suitable through timely amendments. The present acts and policies are providing various incentives and facilities to attract FDI. Some of the acts and the policies of the government are as follows:

First of all, the constitution of the Kingdom of Nepal, 1990 states that the country has felt the need of foreign investment and technology in its pursuit of national development.

In addition, the five year plans have explicitly sought to make investment-friendly policy, especially since the country adhered to the policy of economic liberalization in trade and investment in 1990. The Eight Plan (1992-97) has realized that FDI is to be promoted to optimally utilize the foreign capital, modern technology, management and technical skill in the development of industries within the country.

Similarly, the Ninth Plan (1997-2002) has also accorded great attention to foreign investment, with some strategies, such as- making the process of foreign investment entry and exit simple and transparent promotion of foreign investment by identifying the areas of comparative advantage, foreign investment to be allowed to the service sector.

The on-going Tenth Plan (2002-07) has accorded, as usual, a top priority for the promotion of foreign investment. It has an objective to develop Nepal as an attractive and reliable center for foreign investment at international perspective by making FDI related policies simple, comprehensive and transparent through administrative and legal reforms. Moreover, the Plan has the policy to provide facilities and infrastructure services to investors form One Window arrangement. In no case, facilities and incentives provided to attract FDI in Nepal will be less than available in the neighboring countries. Labor Act will be made more flexible on the basis of comparative advantages, information will be provided to investors to promote investment in Nepal and the Nepalese Embassies will be urged to promote foreign investment in Nepal through mobilizing investors in respective countries.

Instead of the plan-wise policies on FDI promotion, the prime governing acts and policies include Industrial Enterprise (IEA). It includes Industrial Enterprise Act (IEA, 1992), Foreign Investment and Technology (FITTA, 1992) and One window policy, 1992.

5.2 Definition of Foreign Investment and Classification of Industry

As per the FITTA 1992, **'Foreign Investment'** means the following investment bade by a foreign investor in any industry.

1. Investment in Share (Equity)
2. Reinvestment for the earnings derived from the investment in share (Equity).
3. Investment made in the form of loan or loan facilities.

On the other hand, foreign investment individual firm, capacity or corporate body involved in foreign investment or technology transfer including foreign investment or international agency.

'Technology transfer' (wherever used in this thesis follows the definition by the FITTA 1992) means 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 trademark of foreign ownership.
c. Acquiring any foreign technical, consultancy, management and marketing service.

The IEA 1992 further classifies industries in the section (3) as follows:

a. **Manufacturing Industries:**

Industries producing goods by utilizing or processing raw materials, semi-processed materials, by-products or waste-products or any other goods.

b. **Energy-Based:**

Industries generating energy from water resources, wind, solar, coal, natural oil, gas, bio-gas or any other sources.

c. **Agro- & Forest-Based Industries:**

Business mainly based on agriculture or forest products such as integrated sericulture and silk production, horticulture and fruit processing, animal husbandry, dairy industry, poultry farming, fishery, tea-gardening and processing, coffee farming and processing, herbiculture and herb processing, vegetable seed farming, mushroom, vegetable farming or vegetable processing, tissue culture, greenhouse, bee-keeping, honey production, rubber farming, floriculture and production and forestry related businesses such as lease-hold forests, agro-forestry etc.

d. **Mineral Industries:**

Mineral excavation or processing thereof.

e. **Tourism Industries:**

Tourist Lodging, motel, hotel, restaurant, resort, travel agency, skiing, gliding, water rafting, cable-car complex, pony-trekking, trekking, hot air ballooning, parasailing, golf-course, polo, horse riding etc.

f. **Service Industries:**

Workshop, printing press, consultancy service, ginning and baling business, cinematography, construction business, public transportation business, photography, hospital, nursing home, educational and training institution, laboratory, air services, cold storage etc.

g. **Construction Industries:**

Road, bridge, ropeway, railway, trolley-bus, tunnel, overhead bridge and industrial, commercial and residential complex construction and operation.

5.3 Industries not to be Granted Permission for FDI

The government has restricted some industries making foreign investment, which are divided into two parts:

Part (A)

1. Cottage Industries
2. Personal Service Business (Business such as Hair Cutting, Beauty Parlor, Tailoring, Driving Training act.)
3. Arms and Ammunition Industries.
4. Explosives, Gunpowder.
5. Industries Related to Radio-Active Materials.
6. Real Estate Business (Excluding Construction Industries)/
7. Motion Pictures Business (Produced in National Languages).
8. Security Printing.
9. Currencies and Coinage Business.

Part (B)

1. Retail Business.*
2. Travel Agency**
3. Trekking Agency**
4. Water Rafting**
5. Pony Trekking**
6. Horse Riding**

7. Cigarette*, Bidi(Tobacco), Alcohol* (excluding those exporting more than 90 percent).
8. Internal Courier Services.
9. Atomic Energy.
10. Tourist Lodging.**
11. Poultry Farming.
12. Fisheries.
13. Bee-keeping
14. Consultancy Services such as Management, Accounting, Engineering and Legal Services.

However, some changes have been introduced in the Part (B) as marked by asterisks (two asterisks for deleted items and one for some changes) through notification published in the Nepal Gazette on 2062/08/06, which are are follows:

- The Rental Business now onwards refers to other retail businesses except those operating immediately in more than two countries as international chain business.
- The terms 'Cigarettes' and 'Alcohol' are deleted in subsection (7).
- The subsection (14) is replaced by other consultancy services such as Management, Accounting, Engineering and Legal Services except Consultancy Services with 51 percent foreing investment.
- The subsections 2, 3, 4, 5, 6 and 10 are deleted.

5.3 Facilities and Concessions to Foreign Investment As Provided by Different Acts

5.4.1 Industrial Enterprise Act, 1992

Industrial Enterprise Act, 1992 has offered some genuine facilities and concessions on income tax, sales tax, excise duty and custom duty. Some important are stated as follows:

Income Tax Concessions

Income tax shall not exceed 20 percent of total income of industries other than the ones producing cigarettes, bidi, cigar, chewing tobacco, khaini and industries producing other goods of similar nature utilizing tobacco as their basic raw materials and alcohol or beer producing industries. Except tobacco, alcohol, sawmill and catechu related industries, any other industry using 80 percent or more of indigenous raw materials in its products and supplying all its manpower from among Nepali citizens shall be granted a rebate at the rate of 10 percent of the income tax. Likewise, any national priority industry enlisted in Annex. Shall be granted a rebate of 50 percent of the income tax on their income for a period of ten years from the date of operation and other industries enlisted therein shall be granted a rebate of 50 percent of income tax on their income for a period of 7 years from the date of operation. Any industry established in any Remote, Undeveloped and Underdeveloped Areas, other than cigarettes, bidi, cigar, chewing tobacco, khaini industries and industries producing their basic raw material, and industries producing alcohol or beer, shall be granted a rebate of 30, 25 and 20 percent of income tax respectively. If any industry provides direct employment to six hundred or more than six hundred Nepali citizens round the year, it will be in addition to other facilities, granted and additional income tax rebate at the rate of 10 percent for that year. An industry will be entitled for the purpose of the income tax, to deduct the amount of expenses incurred by it for the long-term benefit provided its workers and employees including housing, life insurance, health facilities, education and training. Similarly, the act guarantees that no income tax be imposed to a foreign investor on the interest income earned from foreign loans.

Sales Tax Facilities

Fruit-based fruit processing and cider and wine industries with a fixed asset of up to 2 million and 5 hundred thousand rupees established in Mugu, Humla, Jumla, Dolpa, Kalikot, Bajura, Darchula, Bajhang, Achham, Mustang, Manang, Solukhumbu, Sankhuwasabha and Taplejung districts shall be entitled to sales tax exemption for a period of 10 years and fruit based alcohol industries shall be entitled to sales tax exemption for a period of five years. On the completion of such exemption period, the GoN may extend to additional period of 3 years.

Any other industry utilizing locally available raw materials, chemicals and packing materials etc. on which excise duty, sales tax or both are already imposed, the excise duty, sales tax or both shall be reimbursed. The sales tax on raw materials and ancillary raw materials, etc. shall be reimbursed on the basis of the quantity of the export. Similarly, any industry selling its products in the Export Promotion House, the sales tax levied on raw materials imported for producing the products so produced shall be reimbursed on the basis of the quality of sales and export. Any industry selling its products within the country in any foreign currency, sales tax and premium levied on such product and sales tax levied on the raw materials, auxiliary raw materials etc. utilized in such product will be reimbursed. The sales and premium levied on the production materials of intermediate goods to be utilized for the production of exportable industrial goods, and the sales tax levied on the product shall be reimbursed to the concerned industry producing shall be reimbursed to the concerned industry producing the intermediate goods, on the basis of the quantity of export, within 6 days from the date of sale.

Custom Duty Facilities

The custom duty and premium levied on raw materials and auxiliary raw materials etc. utilized by any industry in connection with its products during its production shall be reimbursed on the basis of the quantity of the exports. Any industry selling its products in the Export Promotion House, the custom duties levied on the raw materials producing the products so sold shall be reimbursed. The custom duty levied on the raw materials, auxiliary raw materials etc. utilized by any industry selling its products within the country in foreign currency shall be reimbursed. The custom duties and premium levied on the production materials of intermediate goods to be utilized for the production of exportable industrial goods shall be reimbursed.The rate of customs to be levied on the basic raw materials which are not produced in Nepal and are required for the production of industrial machinery or of any other goods may not be more than the rate of import duty that may be levied on the import of industrial machinery or ready-made goods as is produced with the use of such raw materials.

Excise Duty Facilities

The excise duty levied on raw materials and auxiliary raw materials etc. utilized by any industry shall be reimbursed on the basis of the quantity of the export. The excise duty levied on such products and the raw materials, auxiliary raw materials etc.shall be reimbursed to the industry selling its product within the country in any foreign currency. The excise duty levied on the production of exportable industrial good and the product shall be reimbursed to the concerned industry producing the intermediate goods on the basis of the quantity of export. If an industry producing finished goods the sales tax and excise duty to be levied on such products will be allowed to be adjusted on the basis of the quantity utilized by the industry producing the finished goods.

Deductions against Taxable Income

If an industry diversifies itself through reinvestment in the same or any other industry or expands its installed capacity by 25 percent or more, modernizes its technology or develops ancillary industries, it shall be entitled to a deduction of 40 percent of new additional fixed assets from its taxable income. Such remission may be deducted on a lumpsum or on an installment basis within a period of three years. A reduction of up to 50 percent from the taxable income for the investment of an industry on process or equipment, with the objective of controlling pollution or which may have a minimum effect on the environment. Pre-operation costs incurred by any industry in connection with skill development training shall be allowed to be capitalized.

After an industry comes into operation, 10percent of the gross profit shall be allowed as a deduction against taxable income on account of expenses related with technology, product development and efficiency improvement. An industry donating an amount of up to 5 percent of its gross income to any school, college, university, hospital, religious place and in social activities shall be entitled to a deduction of such donated amount of gross income spent for the advertisement of the products or promotion services, hospitality and any other similar expenses shall be allowed to be deducted while assessing the taxable income. Similarly, no tax, fee or charge of any kind shall be levied on the machine, tool, equipment, machinery and raw material to be employed by Export Promotion Industry as well as on the products of such industry.

Convertible Foreign Exchange Facilities

Foreign exchange facilities has been provided for the purpose of importing necessary machinery, equipment and tools; spare parts and components; raw materials; auxiliary raw materials and chemical required for the operation of the industry or the sake of technical consultancy; technical assistance; service fee; management fee; patent duty; market research; industrial promotion, sales promotion and so forth.

Concessions on Interest Rates

The enterprises set up within the underdeveloped area are charged 2 percent less interest rate than to any enterprise elsewhere.

Depreciation Facility

The enterprises established under the act shall be entitled to add one third to the rate of depreciation allowed under the existing income tax laws, while calculating depreciation on the fixed assets.

Prohibition of Nationalization

The act has clearly stated that no industry shall be nationalized in the section (21) of the IEA, 1992.

Other Facilities and Concessions

The following industries, in addition to the above-mentioned facilities and concessions, may be granted further facilities and concessions as below:

- Forest-based industry may be made available any forest on lease-hold basis.
- No royalty shall be imposed if any industry generates electricity for its use.
- The GoN may, by notification published in the Nepal Gazette, grant additional facilities to the Export Promotion Industry and prescribed industries established in

the Export Processing Zone (EPZ) and in the government and non-government industrial estate.

- On the recommendation of and with the decision of the Council of Ministers, and by notification published in the Nepal Gazette, additional facilities may be granted to any National Priority Industry or any Industry established in Nepal by way of invention therein.
- Double sales tax shall not be levied on the raw materials products of any industry.

5.4.2 FITTA, 1992

FITTA, 1992 has also provided facilities and concessions to foreign investments, some of which are as follows:

Firstly, a foreign investor shall be levied income tax at a rate of 15 percent only, on the income earned from foreign technical as well as management service fees and royalty. A foreign investor making investment in foreign currency shall be entitled to repatriate the following amount outside the country:

a. The amount received by the sale of the share of foreign investment as a whole or any part thereof;
b. The amount received as profit or dividend in lieu of the foreign investment;
c. The amount received as the payment of the principal of and interest on any foreign loan;

Similarly, a foreign investor shall be entitled to repatriate outside the country the amount received under an agreement for the transfer of technology in such currency as set forth in the concerned agreement.

Provisions Relating to Visa

A foreign national, visiting the country in connection with undertaking any study or carrying out any research with the objective of making investment in the country, shall be provided a Non-tourist Visa for up to 6 months.

In the same way, a foreign investor or dependent family or authorized representative or dependent family of such authorized representative shall, for the purpose of stay in the country, be provided a Business Visa until the foreign investment is retained.

On the other hand, if a foreign investor, who at a time, makes investment in an amount no less than one hundred thousand US Dollar or in convertible foreign currency equivalent thereto and his dependent family shall be granted a Residential Visa until such investment is retained.

Settlement of Disputes

If any disputes arises between a foreign investor, national investor or the concerned industry, the concerned parties shall be required to settle dispute by mutual consultations in the presence of the Department of Industry (DoI).

In case, the dispute could not be settled in the above manner, it shall be settled by arbitration in accordance with the prevailing arbitration rules of the United Nations Commission of International Trade Law (UNCITRAL). However, the arbitration shall be held in Kathmandu and the laws of the land shall be applicable in the arbitration.

Notwithstanding, disputes arising in regard to foreign investment made in the industries with investment as prescribed may be settled as mentioned in the foreign investment agreement.

5.4.3 Other FDI-Supporting Acts

Income Tax Act, 2001

- Only 20 percent income tax on income earned from export.
- Only 20 percent income tax on income earned from the construction and operation of any road, bridge, tunnel, ropeway, overhead bridge.

- Only 20 percent income tax on income from the operation of trolley-bus or tram
- Again 20 percent tax for the industries under BOOT (Build-Own-Operate-Transfer) project that generate, transmit and distribute electricity.
- 40 percent tax for petroleum industry and 25 percent tax for other industries.

VAT Act, 1995

- VAT paid in the process of producing goods that are exported will be reimbursed within 60 days. Otherwise, interests will be returned.

Hydroelectricity Act, 2001

- Adopting a transparent procedure as well as making of suitable incentives to attract national and foreign investors.
- Giving priority to operate hydroelectricity projects on the basis of BOOT (Build-Own-Operate-Transfer)-principle.
- No nationalization of private-owned hydroelectricity project, transmission system and distribution system during licensing.

Communication Act, 1999

- Participating private-sector in the operation and development of communication services in commensurate with spirit of the government-adopted concept of liberalization.

National Aviation Act, 1993

- Developing, extending, promoting and conserving international airways with the investment of national and international or joint investments with the purpose of operating international aviation transportation service.

Privatization Act, 1996

- The provision to buy the privatized enterprises by the national and foreign private sector.

Excise Duty Act, 2001

- No excise duty on exported items.

5.4.4 Industrial Policy (IP), 1992

The Industrial Policy (IP), 1992 has offered incentives to the foreign investors having the permission to invest in convertible foreign currency to repatriate the following outside Nepal at the prevailing rate of exchange:

- The amount received by sale of the whole or any part of the equity investment.
- The amount received as benefits or dividends from foreign investment.
- The amount received as payment of principal and interest on foreign loans.
- The amount received under an agreement for the transfer of technology.
- The amount received under compensation for the acquisition of any property.
- Foreign experts, working in Nepalese industries with prior approval from countries from where convertible currencies are in circulation shall be permitted to repatriate in convertible foreign currency up to 70 percent of the amount received by them as salaries, allowances etc.
- Interest income on foreign loans will be taxed at a rate of 15 percent only.
- Royalties, technical and management fees will be taxed at a rate of 15 percent only.
- No income tax will be levied on the income earned from exports.]
- Industries established with foreign investments are entitled to enjoy all the facilities and concessions including income tax facilities provided to local investment under the IEA, 1992 ensuring the equal treatment to the both investors-- local and foreign.

5.4.5 Foreign Investment and One Window Policy, 1992

The government has made arrangements for the facilitation of FDI in the country with the adoptation of the widely-recommended 'one-stop shop' approach through the Foreign

Investment and One Window Policy, 1992. The One Window Committee formed under DoI in coordination with different line agencies will facilitate the foreign investors all the services such as registration of land, supply of electricity and water, import of machinery, raw materials and spare parts and so on.

CHAPTER VI

DATA PRESENTATION AND ANALYSIS

6.1 Structure of FDI in Nepal

The overall FDI inflow to Nepal from the beginning to 11th June, 2006 (2063/02/28 BS) has been analyzed on the basis of status, sector, category, country, district and year. A Simple Regression Model has been applied to forecast the trend of FDI in Nepal.

6.1.1 Status of FDI in Nepal

The status of the total JVs entered into the country from the beginning to 11th June, 2006 (2063/02/28 BS) can be exhibited with the aid of the following table:

Table 6.1
Status of FDI in Nepal
(From the Beginning to June, 2006)

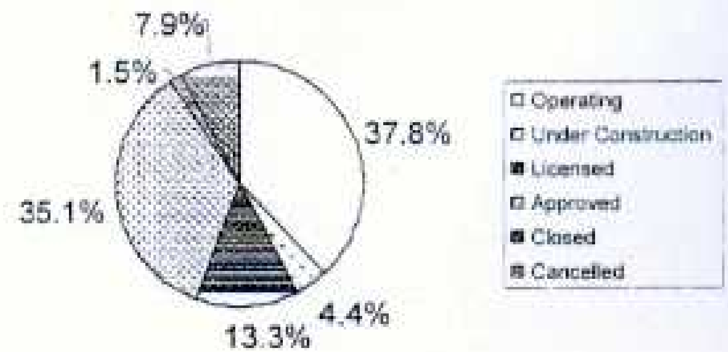
(Rs. in Million)

Categories	No. of Projects	Total Project Cost	Total Fixed Cost	FDI	Percent of Total FDI
Operating	401	47062.28	39836.57	10892.86	37.8
Under Construction	33	5373.74	4866.24	1260.97	4.4
Licensed	122	13040.53	10388.09	3838.58	13.3
Approved	438	17524.64	13287.06	10136.75	35.1
Closed	21	1570.46	1329.68	442.67	1.5
Cancelled	72	8509.20	7380.43	2280.09	7.9
Total	**1087**	**93080.86**	**77088.07**	**28851.91**	**100.0**

Source: DoI, GoN, 2006.

The above table manifests that the number of JVs invested in the country has reached 1087. The total FDI has amounted to 28.8 billion, whereas total investment and total fixed capital are 93.1 billion and 77.1 billion respectively. The ratio of FDI under operating category is 37.8 percent, under construction 4.4 percent, under license 13.3 percent, under approved 35.1 percent, under closed 1.5 percent, under cancelled 7.9 percent. However, the sum total under closed and cancelled category i.e. 2.7 billion which turns out to be 9.4 percent of total FDI, has literally been restraint from the country, as this adds nothing to the productive capacity of the economy. In addition, the categories-- licensed and approved-- implies the lack of attention on the part of the policy-makers. This scenario can better be presented in the pie-chart as follows:

Figure 1
FDI in Nepal- Statuswise
(From the Beginning to June, 2006)



Based on Table 6.1

6.1.2 FDI in Nepal- Sectorwise

The structure of FDI in Nepal can be further analyzed in sectorwise manner with the help of the following table:

Table 6.2
FDI in Nepal- Sectorwise
(From the Beginning to June, 2006)

(Rs. in Million)

Type of Industries	No. of Ind.	Total Project Cost	Total Fixed Cost	FDI	% of Total FDI
Agriculture & Forestry	14	1682.05	1521.27	461.57	1.6
Manufacturing	486	37222.88	27024.32	11739.27	40.7
Food, Beverage & Tobacco	75	9180.29	7968.84	2205.32	7.6
Textile & Rea. Garment	172	8872.06	5617.84	3340.74	11.6
Wood & Wood Product	8	116.36	89.85	41.52	0.1
Paper & Paper Product	23	1824.48	1542.44	334.00	1.2

Chem. & Plastic Product	89	7158.25	5222.57	2953.96	10.2
Non-met Mi Product	20	3831.63	2314.40	1116.03	3.9
Basic Metal Product	25	2199.98	1443.92	693.00	2.4
Febric Metal, M/C	54	3174.12	2205.85	848.32	2.9
Other Manufacturing Units	20	865.70	618.62	206.38	0.7
Electricity	23	19997.77	18212.09	3503.56	12.1
Construction	34	1841.28	1371.31	1119.52	3.9
Hotel & Resort	271	16275.11	15327.74	4864.28	16.9
Transport & Communication	29	4213.68	2914.13	1676.94	508
Housing & Apartment	17	256.43	105.21	145.51	0.5
Service Industries	213	11591.66	10612.00	5341.26	18.5
Total	**1087**	**93080.86**	**77088.07**	**28851.91**	**100.0**

Source: DoI, GoN, 2006.

The Manufacturing sector has attracted the highest portion i.e. 41 percent of the total FDI. Likewise, among the different sub-sectors under Manufacturing, Textile and Garment received the most portions of 12 percent, followed by chemical and plastic production with 10 percent. The second place has been held by Service sector by attracting 19 percent. In the same way, the third place goes to the Hotel and Resort with 16.9 percent of the total FDI. The least percent of total FDI which turns out 0.5 percent in Housing and Apartment.

The Agriculture and Forestry has remained as a vast undeveloped sector. The Electricity, Water, Gas sector has absorbed a moderate percent of 12 percent of the total FDI. The Construction and Transport and Communication have added 4 and 6 percent of the total FDI respectively. This indicates that the sectors other than Manufacturing need greater amount of FDI.

6.1.3 FDI in Nepal- Categorywise

The following table shows the amount of investments in each of the seven types of industries, as defined by the Industrial Enterprise Act, 1992.

Table 6.3
FDI in Nepal- Categorywise
(From the Beginning to June, 2006)

(Rs. in Million)

Types of Industries	No. of Projects	Total Project Cost	Total Fixed Cost	FDI	% of Total FDI
Agriculture	15	440.15	385.20	101.76	0.4

Construction	21	1145056	878.64	653.92	2.3
Energy-Based	18	19703.30	18042.47	3402.15	11.8
Manufacturing	489	38037.33	27548.05	12510.72	43.4
Mineral	3	1153.14	1068.32	45.98	0.2
Service	273	16521.23	13897.60	7432.81	25.8
Tourism	268	16080.15	15267.80	4704.57	16.3
Total	**1087**	**93080.86**	**77088.07**	**28851.91**	**100.0**

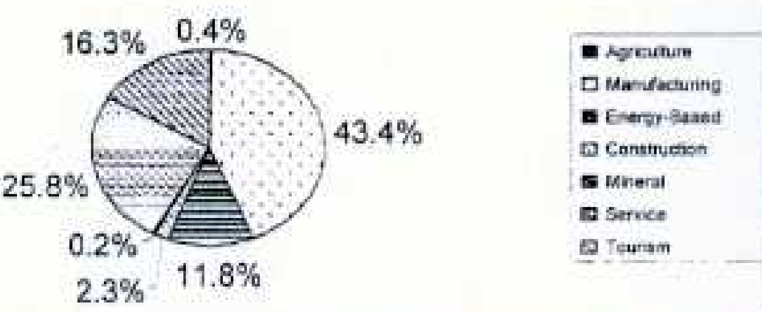
Source: DoI, GoN, 2006.

Of the seven industries, Manufacturing industries have received the highest percent of 43 of the total FDI worth Rs. 12.5 billion, followed by Service industry with 26 percent. This implies the growing popularity and potentiality of service industry in FDI. Similarly, the third and forth positions in respect to taking higher percent of total FDI are held by tourism (16 percent) and energy-based industry (12 percent) respectively. The another thing is that mineral-based industry has attracted the least percent of total FDI, possibly due to inaccessibility and high cost of the project. Furthermore, agriculture has absorbed a meager percent of 0.4. The agriculture is considered as the backbone of the developing economy like that of Nepal. The rapid and sustainable socio-economic development of the country is possible only through the modernization of agriculture sector- commercialization, industrialization and mechanization- which naturally requires a huge amount of FDI inflow in this sector. The reason behind this phenomenon may be primarily due to the poor physical infrastructures. The above table can be presented with the help of the following pie chart:

Figure 2

Percentage of FDI in Different Type of Industries

(From the Beginning to June, 2006)



Source: Based on Table 6.3

6.1.4 FDI in Nepal- Countrywise

The following table gives more information on the Joint Venture (JV) industries in Nepal by different countries:

Table 6.4
Joint Venture Industries in Nepal- Countrywise
From the Beginning to June, 2006

(Rs. in Million)

S.N.	Country	No. of JVs	Total Project Cost	Total Fixed Cost	FDI
1.	Australia	10	272.59	233.82	221.50
2.	Austria	9	171.06	130.71	48.86
3.	Azerbaijan	1	7.40	6.70	7.40
4.	Bangladesh	13	448.64	209.04	213.70
5.	Belgium	4	17.27	14.40	12.24
6.	Bermuda	6	1995.25	1694.03	118.27
7.	Bhutan	3	27.26	20.58	3.61
8.	Brazil	2	21.07	7.50	4.43
9.	Bri. Virg. Is.	4	3439.78	3301.19	1282.94
10.	Canada	10	725.98	632.91	578.80
11.	China	122	9639.25	7924.11	3013.82
12.	Denmark	5	531.02	470.88	34.69
13.	Finland	3	12.50	8.36	7.05
14.	France	26	456.59	382.15	183.26
15.	Germany	46	1849.32	1671.27	612.17
16.	Ghana	1	6.50	6.18	1.95
17.	Guatemala	1	10.00	5.00	2.50
18.	Hong Kong	15	1343.54	1099.44	525.24
19.	India	335	34095.76	26185.36	11570.37
20.	Iran	4	14.20	8.30	10.20
21.	Ireland	1	5.00	1.00	1.50
22.	Israel	4	613.10	507.63	76.50
23.	Italy	15	1227.95	1113.16	180.27
24.	Japan	112	2914.17	2510.47	982.00
25.	Malaysia	7	524.64	491.47	82.08
26.	N.Korea	1	44.82	41.20	12.55
27.	Netherlands	13	1093.76	910.77	434.73
28.	New	7	283.63	228.66	17.07

	Zealand				
29.	Norway	7	8035.59	6692.40	1061.33
30.	Pakistan	12	315.75	228.71	137.33
31.	Panama	1	83.28	65.17	24.98
32.	Philippines	5	936.68	861.53	52.85
33.	Poland	3	92.22	87.55	9.89
34.	Portugal	1	2.50	2.00	2.50
35.	Russia	6	145.55	100.43	54.49
36.	S.Africa	3	32.50	26.84	32.50
37.	S.Korea	61	1809.35	1502.70	964.95
38.	Singapore	12	1618.02	1560.19	346.49
39.	Slovenia	1	4.19	3.94	4.19
40.	Spain	5	67.22	44.26	37.23
41.	SriLanka	3	79.15	55.90	37.41
42.	Sweden	2	3.20	2.41	3.20
43.	Switzerland	22	532.48	478.25	145.95
44.	Taiwan	8	412.75	358.83	172.62
45.	Thailand	8	953.12	813.38	91.64
46.	Turkey	3	13.70	8.32	26.20
47.	UAE	1	178.54	37.24	45.00
48.	UK	44	2644.74	2229.09	829.84
49.	Ukraine	1	90.00	82.00	14.70
50.	USA	100	13238.31	12030.66	4516.95
	Total	**1087**	**93080.86**	**77088.07**	**28851.91**

Source: DoI, GoN, 2006.

The number of countries which have made investments in Nepal has hit 50. Among them, India stands at the first position with the greatest number of 335 joint ventures with the total investment of Rs. 11.5 billion. The second position is occupied by USA making the investment of Rs. 4.5 billion. The number of foreign collaborations invested by different countries has not been evenly. The neighboring economies- India and China- have shown great interest in investing in Nepal, as FDI collaborations by these two countries stand at the first and second position respectively.The countries with five and/or less JVs companies of about 50 percent of the total number of investing countries. This implies the need to offer more incentives to these countries to make greater investments as they have already chosen

Nepal as their investment destination. However, their contribution to the total FDI is no more than 6.06 percent.

The seven countries making highest number of JVs viz. India, USA, China, Britain Virginia Island, Norway, Japan, S.Korea account for more than 80 percent of total number of JVs and around 78 percent of total FDI. This exhibits the heavy concentration of few countries on FDI inflow, which is not a positive signal and calls for a need to diversification of countries through special incentives packages offerings to them and making sound infrastructures and efficient administrative mechanism ensuring good governance.

6.1.5 FDI in Nepal- Districtwise

The following table gives the data regarding the distribution of the FDI in different districts of the country:

Table 6.5
JVs in Nepal- Districtwise
(From the Beginning to June, 2006)

(Rs. in Million)

S.N.	District	No. of Ind.	Total Project Cost	Total Fixed Cost	FDI	% of Total FDI
	Eastern Development Region					
1.	Dhankuta	1	46.62	37.62	0.00	0
2.	Jhapa	8	798.64	499.73	137.62	0.48
3.	Morang	23	2088.85	1507.48	346.48	1.20
4.	Saptari	1	160.00	144.00	160.00	0.55
5.	Siraha	2	644.00	625.07	97.20	0.34
6.	Solukhumbu	6	1052.37	975.85	19.33	0.07
7.	Sunsari	13	2101.17	1550.28	1039.25	3.60
8.	Taplejunj	1	2.10	1.04	1.90	0.007
	Total	*55*			*1801.78*	*6.24*
	Central Development Region					
9.	Bara	40	7117.05	5640.20	1923.78	6.67
10.	Bhaktapur	32	1704.38	995.45	601.11	2.08
11.	Chitwan	34	3231.17	2569.77	972.56	3.37

12.	Dhading	7	405.89	363.30	171.00	0.59
13.	Dolkha	3	5070.20	4568.03	775.73	2.69
14.	Kathmandu	548	24791.46	20355.05	9419.19	32.65
15.	Kaver	29	841.29	671.33	406.22	1.41
16.	Lalitpur	112	5861.13	4339.22	3048.43	10.57
17.	Makawanpur	36	3248.37	2456.72	849.72	2.95
18.	Nuwakot	4	133.88	128.05	29.00	0.10
19.	Parsa	31	2410.49	1892.45	1241.87	4.30
20.	Ramechhap	1	291.34	237.89	262.21	0.91
21.	Rasuwa	4	2287.52	2219.50	595.71	2.06
22.	Rautahat	1	559.18	509.18	44.06	0.15
23.	Sindhupalchowk	6	6777.73	6556.09	1237.08	4.29
24.	Kavrepalenchok	1	30.00	28.00	20.40	0.07
	Total	*889*			*21568.07*	*74.86*
	Western Development Region					
25.	Gorkha	3	694.09	640.02	65.23	0.23
26.	Kapilbastu	6	360.71	170.53	248.31	0.86
27.	Kaski	53	9733.09	9198.15	2802.49	9.71
28.	Lamjunj	3	193.93	168.65	39.15	0.14
29.	Manang, Tanah	1	75.00	69.75	47.01	0.16
30.	Mustang	2	461.74	449.11	1.07	0.004
31.	Nawalparasi	17	2572.68	2213.76	315.40	1.09
32.	Palpa	1	30.00	23.38	4.90	0.02
33.	Parbat	1	1100.00	1089.00	1.50	0.01
34.	Rupandehi	23	2608.69	19736.54	963.70	3.34
35.	Tanahu	2	79.02	64.70	27.50	0.01
36.	Argakhachi	1	1242.09	119.68	448.00	1.55
	Total	*113*			*4964*	*17.21*
	Mid-Western Development Region					
37.	Banke	11	441.36	350.14	111.64	0.39
38.	Bardiya	4	39.88	35.56	11.64	0.04
39.	Rolpa	1	3.22	3.00	0.00	0
	Total	*16*			*123.28*	*0.43*
	Far-Western Development Region					
40.	Achham	2	61.38	51.68	48.18	0.17
41.	Kailali	1	901.54	855.21	175.30	0.61

42.	Kanchanpur	8	716.37	644.41	90.72	0.31
	Total	*11*			*314.20*	*1.09*
	Others					
43.	Out of Valley	1	24.34	21.22	24.34	0.08
44.	Terai Region	1	60.00	55.00	16.00	0.06
45.	Undefined	1	26.67	20.31	10.00	0.03
	Grand Total	**1087**	**93083.86**	**77088.07**	**28851.91**	**100.00**

Source: DoI, GoN, 2006.

FDI projects have been set up in the different districts of the country. The total number of districts having FDI industry has marked 43 indicating that there are still 32 districts with no FDI. Kathmandu has succeeded in attracting the highest number of FDI industries of 548, which is followed by Lalitpur with 112. Kaski stands at the third place with far less number of 53 FDI industries. But sadly, 15 districts has only one FDI industry each, whereas 26 districts has less than 5. Kathmandu is blessed with half of the total number of FDI industries, which has portrayed a heavy concentration of FDI industries in the urban area only, confining overall economic advantages to the limited area. Moreover, this will have less impact in uplifting the life standard of the rural people, whom rather need more FDI industries to tap the unused natural (and human) resources. As-a-matter-of-fact, the country need to make planning and policies so as to encourage foreign investors in rural and sub-urban area through the infrastructural development so that the concept of balanced socio-economic development could be achieved.

History shows that the outcome of unbalanced development in case of giving economic opportuniteies and equal political participation causes costly economical and political upheavals devestating enough to put the country at risk. Hence, the economic opportunities should be offered to the people of the country- not only of the urban area but also the rural area. By the same token, the state should create such an environment so that FDI industries will get diversified across the country.

Looking on the districtwise FDI, the highest FDI has been made in Kathmandu worth Rs. 9.4 billion, which is 33 percent of total FDI. Better availability of basic infrastructures such as transport, electricity, communication etc., abundance of manpower, administrative advantages, security and the like are the responsible factors for the highest FDI being made in Kathmandu. The second place goes to Lalitpur with Rs. 3 billion equivalent to 11 percent which is situated next to Kathmandu district and has favourable enviroment for FDI. In the same way, at the third place is Kaski with 2.8 billion contributing 10 percent of total FDI, which again possesses the headquarter of the Western develolpment region. Most importantly, the remaining districts have the share of less than 5 percent of the total FDI. This exhibits that a vast number of districts are yet to reap the benefits of FDI in rising production, employment and income of the people, mostly rural ones.

Additionally, the same data can be looked upon with the reference to the development region. The Central development region holds 75 percent of total FDI, topping all others. At the second place is the Western development region with 17.21 percent. This shows the gross inequality in the distribution of FDI between the two highest FDI receiving development regions. The state of the other development regions are even more disgraceful. The Eastern development region receives the 6 percent of the total FDI, as the Mid-Western and Far-Western development region receives 0.30 and 1 percent respectively. This is the indication of red signal situation that the Far-Western and Mid-Western development region are literally out of the FDI-network in Nepal. This urges a strong need to prepare the prerequisite of development-- physical infrastructures and pave way for making conducive business environment in these regions through improved legal provision and incentives. Thanks to the technical mistakes by the government agencies, approximately 0.2 percent of FDI has been recorded under the heads of 'Undefined', 'Out of Valley' and 'Terai Region' which exposes laxity on the part of the administrators, though the government has disbursed a big budget to look on the matters of foreign investment.

6.1.7 FDI in Nepal- Yearwise

The FDI-related projects with their investments in yearwise basis can be displayed in the following table:

Table 6.6
FDI in Nepal-Yearwise
(From the Beginning to June, 2006)

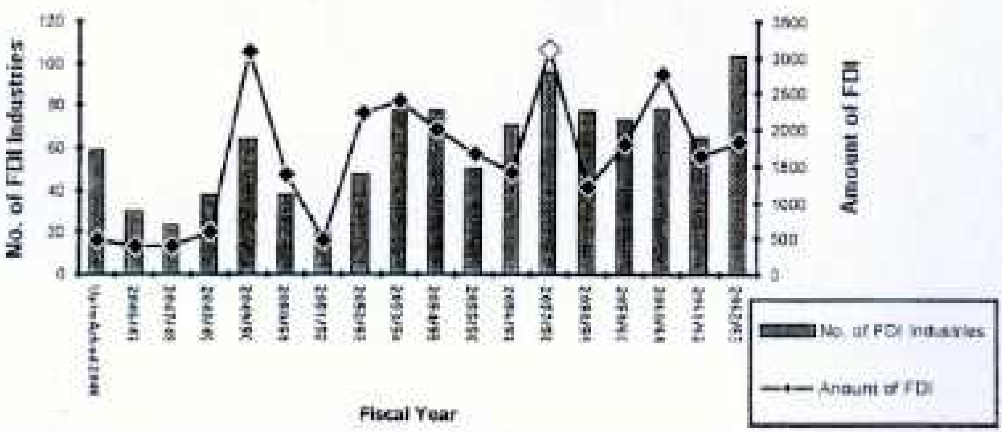
(Rs. in Million)

Fiscal Year	No. of Projects	Total Project Cost	Total Fixed Cost	FDI
Up to Ashad 2046	59	5425.92	4581.82	466.84
2046/47	30	2438.19	2139.60	398.51
2047/48	23	863.56	690.74	406.28
2048/49	38	3508.17	2902.10	597.84
2049/50	64	178860.22	16210.81	3083.67
2050/51	38	3733.23	3175.66	1378.76
2051/52	19	1627.28	1247.85	477.59
2052/53	47	10047.47	9398.54	2219.86
2053/54	77	8559.25	6692.15	2395.54
2054/55	77	5569.38	5142.32	2000.28
2055/56	50	5324.42	4380.17	1666.42
2056/57	71	2669.09	1910.24	1417.61
2057/58	96	7917.62	6122.49	3102.56
2058/59	77	3318.53	1559.59	1209.65
2059/60	74	4921.82	3608.25	1793.77
2060/61	78	4323.74	3775.86	2764.80
2061/62	65	1804.12	1153.78	1642.54
2062/63	104	3142.86	2396.12	1829.38
Total	**1087**	**93080.86**	**77088.07**	**28851.91**

Source: DoI, GoN, 2006.

The table indicates that there have been fluctuations in the number of foreign collaborations entered into the country over the years. 59 had been established up to 1988/89 (Ashad, 2046). The FY 2062/63 witnesses the highest number of foreign collaborations which have started their operation in the country, followed by the FY 2057/58 with 96 foreign collaborations. Viewed from another way, the highest FDI was made in the country in FY 2057/58 with Rs.3.1 billion and the second highest FDI in FY 2049/50 worth Rs. 3.1 billion. However, the FY 2062/63 has witnessed a meager amount of FDI worth Rs. 1.8 billion. What it implies is that the greater foreign collaborations with lesser FDI have taken place. The periodic trend of FDI can be presented in the following bar diagram:

Figure No.
Yearwise Comparison of FDI Industries and Total FDI
(From the Beginning to June, 2006)



Based on Table 6.6

Trend Line of Overall FDI

In bid to fit the future trend of the overall FDI, the following model has been applied:

$F = a + bT$

Where, F = FDI in billion, T = Time periods: 0,1,2,3, ..., 16, a & b = parameters.

With the help of the Least Square Method, the normal equations are:

$\sum F = Na + b\sum T$

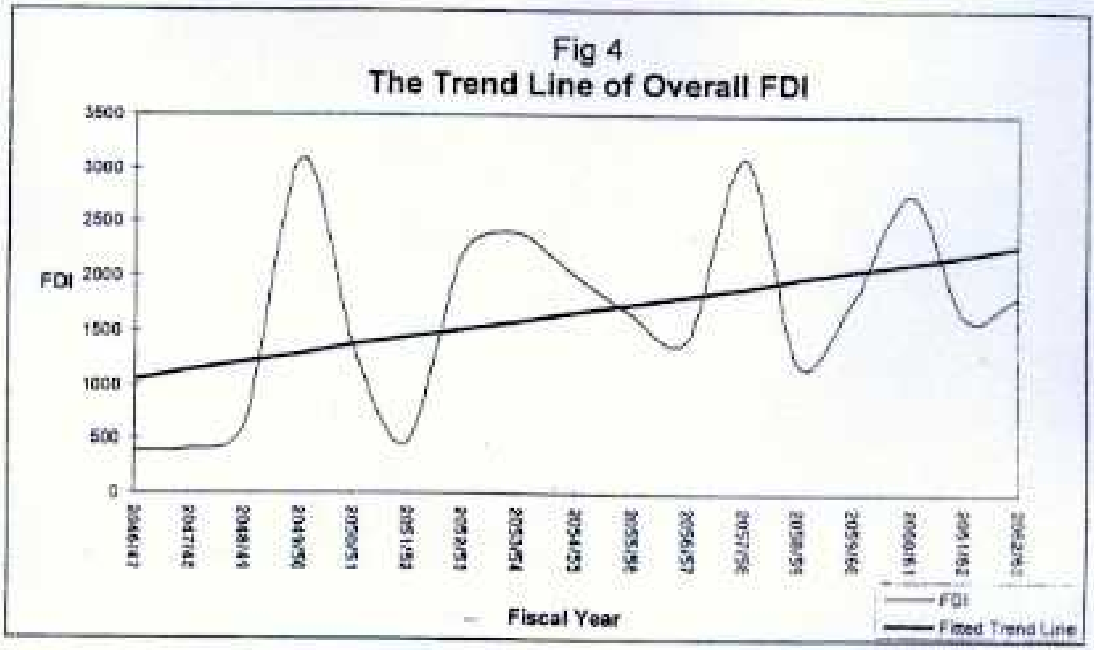
$\sum FT = a\sum T + b\sum T^2$

From the calculations from the table 6 (enlisted in the Annex 1), the following Regression Line has been arrived at:

$\therefore \mathbf{F = 1.055 + 0.077\ T}$

Result: This fitted line shows that the overall FDI has an upward trend and it has annually grown by 0.77 billion rupees during the study period. The Regression Line predicts that in the FY 2063/64 (i.e. T=17) overall FDI will be Rs. 2364 million. However, the parameters of the equations are statistically significant at 10 percent level of significance.

shown by low value of R^2 and $\overline{R}^2$ (being 0.196 and 3.07 respectively), this prediction has very little significance in practical terms. This can be displayed in the following figure:



Based on Table 6.6

6.2 Employment Opportunities via FDI Nepal

The opportunities of employment due to the FDI inflow in Nepal has been analyzed status, sector, country, district and year-wise in the following way:

6.2.1 Employment Generation via FDI in Nepal- Statuswise

In view of the status of foreign collaborations, the overall employement situation can be displayed in the following table:

Table 6.7
Employment in FDI Projects in Nepal- Statuswise
(From the Beginning to June, 2006)

Categories	No. of Projects	Employment	Percent of Total Employment
Operating	401	50176	47.5
Under Construction	33	4303	4.1
Licensed	122	15114	14.3
Approved	438	24965	23.6
Closed	21	1924	1.8
Cancelled	72	9194	8.7
Total	**1087**	**105676**	**100.0**

Source: DoI, GoN, 2006.

The industries set up via FDI have provided the employment opportunities to the labor-force of around 105676 during the period of 1988/89 to 2006 June, which is around 0.6 percent of the total population and about 0.9 percent of the economically active population of the country.The highest percent of total employment have been employed in operational industries with 48 percent. The industries under approved, licensed and construction has accounted for 24, 14 and 5 percent of total employment respectively. However, the employment of 10 thousand i.e. 11 percent of total employment, which falls under the closed and cancelled industries, has literally no contribution to the employment generation in the economy. This indicates that the number of employment under closed and cancelled should be reduced, for this, the reasons for these industries to shut their production in Nepal should be carefully found out and worked toward solving their problems.

6.2.2 Employment Generation via FDI in Nepal - Sectorwise

One of the most important reasons why FDI is welcome in almost all the countries in the world irrespective of their status of development is due to the fact that it provides the host country with resources (materials and technical skills) to broaden the national production frontier along with vast opportunities of employment to the inhabitants. The creation of employment for the masses arises because investment in any sector does not yield any productive outcomes without the employment of human labor-force. The following table depicts the employment situation generated by FDI industries in each of the seven industries in a lucid manner:

Table 6. 8
Employment Generation in FDI Projects in Nepal- Sectorwise
(From the Beginning to June, 2006)

Types of Industries	No. of Projects	Total Employment	Average Employment
Agriculture	15	1023	68
Construction	21	1449	129
Energy-Based	18	4899	60
Manufacturing	489	63248	65
Mineral	3	1129	69
Service	273	17763	272
Tourism	268	16165	376
Total	**1087**	**105676**	**97**

Source: DoI, GoN, 2006.

Out of the total employment, the Manufacturing industry has yielded the highest number of employment of 63248, which is followed by Service industry to 17763 and Tourism industry to 16165. Similarly, Agriculture has succeeded in offering employment to 1023 only.

Analyzing the table further, it can be said that the mineral-based industry has the highest average sector employment. The energy-based industry has the second highest average employment. The reasons for this phenomenon are due to the labor-intensive nature of the industry, the need of large unskilled labors for carrying equipments and other necessary goods to the project sites and the low use of modern machines due to the problem of inaccessibility.

The agriculture industry has the average employment of 68, whereas construction and service industry has that of 69 and 65 respectively. Among all, tourism industry employs the least average employment of 60. This implies that the agriculture and tourism sector at which the country has vast resources has not received the desired level of employment.

6.2.3 Employment Generation via FDI in Nepal - Countrywise

The total and average country employment the investing countries have been given in the following table:

Table 6. 9
Countrywise Comparison of Employment by JVs of Different Countries
(From the Beginning to June, 2006)

S.N.	Country	No. of Joint Ventures	Total Employment	Average Country Employment
1.	Australia	10	381	38
2.	Austria	9	361	40
3.	Azerbaijan	1	27	27
4.	Bangladesh	13	3766	290
5.	Belgium	4	110	28
6.	Bermuda	6	1474	246
7.	Bhutan	3	98	33
8.	Brazil	2	221	111
9.	Bri.Virg. Is.	4	1210	303
10.	Canada	10	1329	133
11.	China	122	8881	73
12.	Denmark	5	398	80
13.	Finland	3	104	35
14.	France	26	1325	51
15.	Germany	46	2860	62
16.	Ghana	1	0	0

17.	Guatemala	1	84	84
18.	Hong Kong	15	2075	138
19.	India	335	43360	129
20.	Iran	4	69	17
21.	Ireland	1	40	40
22.	Israel	4	117	29
23.	Italy	15	329	25
24.	Japan	112	5592	50
25.	Malaysia	7	252	36
26.	N.Korea	1	71	71
27.	Netherlands	13	2152	166
28.	New Zealand	7	1664	285
29.	Norway	7	538	77
30.	Pakistan	12	2365	197
31.	Panama	1	121	121
32.	Philippines	5	1394	179
33.	Poland	3	77	26
34.	Portugal	1	23	23
35.	Russia	6	406	68
36.	S.Africa	3	84	28
37.	S.Korea	61	3359	55
38.	Singapore	12	1196	100
39.	Slovenia	1	0	0
40.	Spain	5	158	32
41.	SriLanka	3	83	28
42.	Sweden	2	18	9
43.	Switzerland	22	352	16
44.	Taiwan	8	571	71
45.	Thailand	8	1106	138
46.	Turkey	3	54	18
47.	UAE	1	93	93
48.	UK	44	5872	133
49.	Ukraine	1	18	18
50.	USA	100	9108	91
	Total	**1087**	**105676**	**97**

Source: DoI, GoN, 2006.

Among the total number of 50 countries with their investments in Nepal, India has offered the highest number of employment of 43360, followed by USA (9108), China (8881), UK (5872), Japan (5592) and so on. The employment provided by Slovenia and Ghana with a JV each happens to be zero. On the other hand, Bri.Virg. Is. has the highest average country employement of 303, while the second position has been occupied by Bangladesh with (290), followed by New Zealand (285) and Philippines (279).

6.2.4 Employment Generation via FDI in Nepal - Districtwise

The generation of employment by the FDI industries can be analyzed districtwise with the help of the following table:

Table 6.10
Employment in FDI Projects- Districtwise
(From the Beginning to June, 2006)

S.N.	District	Total Employment	Percent of Total Employment
	Eastern Development Region		
1.	Dhankuta	120	0.1
2.	Jhapa	2244	2.1
3.	Morang	4733	4.5
4.	Saptari	144	0.1
5.	Siraha	452	0.4
6.	Solukhumbu	47	0.04
7.	Sunsari	2838	2.7
8.	Taplejunj	0	0
	Total	*10578*	*10*
	Central Development Region		
9.	Bara	4201	4.0
10.	Bhaktapur	3253	3.1
11.	Chitwan	7093	6.7
12.	Dhading	440	0.4
13.	Doikha	115	0.1
14.	Kathmandu	41274	39.1
15.	Kaver	3646	3.5
16.	Lalitpur	8373	7.9
17.	Makawanpur	2947	2.8
18.	Nuwakot	433	0.4
19.	Parsa	4380	4.1
20.	Ramechhap	200	0.2

21.	Rasuwa	66	0.06
22.	Rautahat	589	0.6
23.	Sindhupalchowk	2452	2.3
24.	Kavrepalenchok	40	0.04
	Total	*8052*	*76.20*
	Western Development Region		
25.	Gorkha	654	0.6
26.	Kapilbastu	164	0.2
27.	Kaski	2906	2.7
28.	Lamjunj	420	0.4
29.	Manang, Tanah	635	0.6
30.	Mustang	115	0.1
31.	Nawalparasi	2565	2.4
32.	Palpa	24	0.02
33.	Parbat	2614	2.5
34.	Rupandehi	1761	1.7
35.	Tanahu	137	0.1
36.	Argakhachi	40	0.2
	Total	*12166*	*11.50*
	Mid-Western Development Region		
37.	Banke	1179	1.1
38.	Bardiya	199	0.2
39.	Rolpa	18	0.02
	Total	*1396*	*1.30*
	Far-Western Development Region		
40.	Achham	0	0
41.	Kailali	728	0.7
42.	Kanchanpur	1117	1.1
	Total	*1845*	*1.70*
	Others		
43.	Out of Valley	70	0.7
44.	Terai Region	97	0.1
45.	Undefined	22	0.02
	Grand Total	**1087**	**100.00**

Source: DoI, GoN, 2006.

The Kathmandu district has marked the highest percent i.e. 39 of the total employment. At the second position is Lalitpur with 8 percent. The Chitwan district occupies the third place with 6.7 percent, followed by Morang with 4.5 percent of the total employment. The table manifests the vast inequality in the distribution of the total employment among districts. The heavy concentration of employment in the Kathmandu district indicates that the benefits of FDI has not been distributed evenly among the people across the country.

The distribution of total employment via FDI industries in respect to the development regions shows rather a worse picture. The Central development region has accounted for the highest percent of 76.2. The Eastern development region has taken 10 percent of the total employment and the Western development region, 11.5 percent. The Far-Western developmnet region as well as Mid-Western development region has received a dimunitive percent of less than 2. This clearly exhibits an alarming condition of the distribution of employment offered by FDI industries in that this can fuel the political conflict and cause social unrest worsening the income inequality among the people. Therefore, the urgent need is to lessen the inequality prevailing in the distribution of employment among the all development region by focusing on rapid and sound development of infrastructures along with exploring virgin areas for FDI. Only then, the country could use FDI as the means to break the vicious cycle of poverty and as the foundation stone necessary for a modernized economy.

6.2.5 Employment Generation via FDI in Nepal - Yearwise

The yearwise employment generation through FDI-industries in the economy has been given in the following table:

Table 6.11
Employment in FDI Projects- Yearwise
(From the Beginning to June, 2006)

Fiscal Year	No. of Projects	Total Employment	Average Year Employment
Up to Ashad 2046	59	10586	117
2046/47	30	9515	317
2047/48	23	2974	129
2048/49	38	5615	148
2048/49	64	13873	217

2050/51	38	4734	125
2051/52	19	2386	126
2052/53	47	8032	171
2053/54	77	9347	121
2054/55	77	4336	56
2055/56	50	2146	43
2056/57	71	4703	66
2057/58	96	6880	72
2058/59	77	3731	48
2059/60	74	3572	48
2060/61	78	2144	27
2061/62	65	5591	86
2062/63	104	5511	53
Total	**1087**	**105676**	

Source: DoI, GoN, 2006.

The trend of total employment over the years has been somewhat fluctuatory. The employment-level up to 2046 Ashad has marked 10586. The FY 2049/50 has observed the highest number of employment i.e. 13873. Among the years under consideration, the FY 2060/61 has witnessed the least number of 2144. Alternatively, if viewed from average year employment, the FY 2046/47 has the highest with 317, followed by FY2049/50 with 217, the FY 2052/53 with 171 and others. The average year employment has shown fairly downward trend with the escalation of political instabililty in the country, especially after FY 2057/58.

6.3 Technology Transfer in Nepal via FDI

The following table provides the information on FDI and technology transfer agreement type- and scalewise.

Table 6.12
FDI Projects and Technology Transfer- By Type- and Scalewise
(From the Beginning to 2062/63 FNM i.e. April 2006)

(Rs. in Million)

Category of Industries	No. of Projects	Type			Scale		
		Equity Invest.	Equity Invest. & TT	Tech. Transfer Only	Small	Medium	Large
Manufacturing	486	406	39	41	324	103	59
Agriculture	15	14	0	1	10	5	0
Energy-Based	17	17	0	0	2	4	11
Construction	21	19	2	0	11	7	3
Mineral	3	1	1	1	1	0	2
Service	265	255	3	7	213	34	18
Tourism	260	250	6	4	207	23	30
Total	**1067 (100%)**	**962 (90.2%)**	**51 (4.8%)**	**54 (5.1%)**	**768 (72.0%)**	**176 (16.5%)**	**123 (11.5%)**

Source: DoI, *Industrial Statistics*, GoN, 2006.

As per the acts and the policy of the GoN, foreign collaboratin can be either financial or technical and/or both. In case of financial collaboration, the 50 to 100 percent ownership are allowed except in certain industries, but technology transfer or technical collaboration is open to all types of industries. Up to 2062/63 FNM, the number of FDI industries marked 1067.

Among the total FDI industries, 962 were financed through equity investment, which becomes 90 percent of total FDI industries. Likewise, 51 industries bearing 5 percent of total FDI were established in way of equity investment and technology transfer; while that of 54 industries making up 5 percent of the total FDI industries made use of technology transfer only. This shows that technology transfer has not taken place in higher level. Under equity investment, manufacturing sector consisted of the highest number of industries. The reason for this might be due to relative easiness of this method over other ones. This was followed by service sector with 255 industries. The tourism held the third position with 250 industries. The agro-based, energy-based and construction industries, relatively in a lesser degree, adopted the equity investment. The mineral sector had the least number of one industry, established through equity investment. The low profitability in comparison to the risks might have caused for low utilization of equity investment in these sector.

Similarly, under equity investment and technology transfer, the situation is even more disheartening. The manufacturing sector had the highest percent of total FDI industry making use of equity and technology transfer, followed by tourism sector with meagre number of 6. The agro-based and energy-based had no industries, which might be owning to less profitability, caused by inaccessibility; sense of insecurity; highly expensive to bring in and install; lack of skilled technical manpower for maintenance/repairing of the technology and defective government policies with red-tapism in the administration.The other sector had less than 3 industries under this method.

The manufacturing sector had the highest number of 41 industries coming under technology transfer only possibly because of the relatively high profitability and relatively easier for operation of the technology. However, the number of industries with technology transfer only has not been higher. The service sector stands on second place. The tourism sector has 4 industries. The energy-based and construction have no industries making technology transfer. Lack of skilled manpower, chronic sense of insecurity, highly expensive technology in comparison to the benefits it occrues, limited market-place, lack of trained manpower and experts and indifferent governmental policies are the prime reasons for this phenomenon.

Considering the FDI industries with reference to scale among different categories, the highest number FDI industries were small-scale ones contributing to 72 percent to the total FDI industries. The manufacturing sector had again the highest number of industries in the total small-scale industries. The second and third place were occupied by service and toursim sector.

The total number of medium-scale FDI industries had amounted to 176 representing 17 percent of the total FDI industries, of which the highest were in manufacturing sector, followed by service and tourism. The mineral-based sector had no medium-scale industries. The medium-scale industries under energy-based, agro-based and construction categories less than 7 percent. Llimited market ushered by landlockedness geo-position of the country, lack of skilled manpower, sense of insecurity triggered by the Maoist insurgency, faulty governmental played vital roles for for 16 percent of total FDI industries being medium-scale.

The amount of large-scale FDI industries had totalled 123 carrying 12 percent of the total industries. At the first place with the highest number of medium-scale industries had been ventured in manufacturing sector. The second and third place was occupied by tourism and service respectively. Energy-based attracted 11 large industries. Besides, Agro-based sector possessed no large industry at all. Similarly, the Mineral-based and Construction sector owned the large industries of 2 and 3 respectively. Lower profitability, limited market, need for highly expensive technology and manpower, sense of insecurity due to internal political conflict by the Maoists, ineffective, inappropriate and untimely government policies, rugged topography etc. account for faint performance of large industries in attracting FDI.

6.4 Structure of FDI in the Service Sector in Nepal

The analysis of the FDI in the Service Sector has been made on the basis of scale, country, district and year. A Simple Regression Model has also been fitted to forecast the trend of the FDI in the Service Sector in the following:

6.4.1 FDI in the Service Sector in Nepal- Scalewise

The following table clarifies the propensity of the foreign investors on investing in the different scales of industries:

Table 6.13
FDI in the Service Sector in Nepal- Scalewise
(Up to FY 2062/63 FNM i.e. April, 2006)

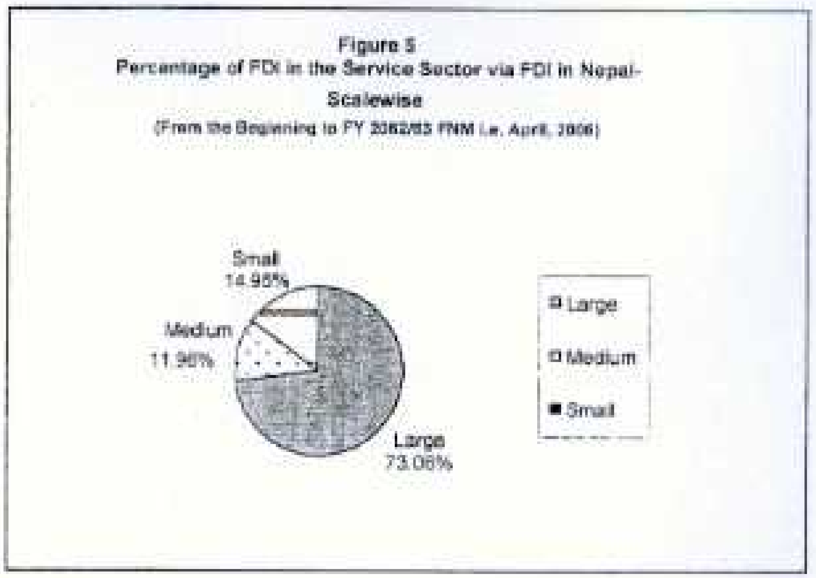
(Rs. in Million)

Scale	No. of Industry	Total Project Cost	Total Fixed Cost	FDI	Percent of Total FDI
Large	18	12633.22	11069.01	5410.04	73.06
Medium	34	1867.87	1557.95	887.32	11.96
Small	213	1979.53	1242.33	1107.35	14.95
Total	**265**	**16480.62**	**13869.29**	**7404.71**	**100.00**

Source: DoI, Industrial Statistics, GoN, 2006.

Looked upon the FDI industries in service sector scalewise, all the three scales of industries are invested in. The interest of foreign investors in the service sector has been found to be growing. The total number of industries in the service sector has reached 265 up to 13 April, 2006 with the total FDI of Rs. 7.4 billion. The total project cost and total fixed costs have hit Rs. 16.5 and 13.7 billion respectively. The highest portion of the total FDI invested in the sercive sector goes to large-scale industries (74 percent) with Rs 5.4 billion , followed by small-scale industries (15 percent) with Rs. 1.1 billion. The medium-scale industries has only 12 percent of total FDI.

This is a satisfactory situation, as the economy needs large-scale industries especially through FDI to translate the dream of industrial revolution into reality. Further, the economy of scale generated by large industries fuel the expansion the economy. However, the small-and medium-scale industries has not been able to attract a sufficient volume of FDI. This can be presented in the following pie-chart:



Based on Table 6.13

6.4.2 FDI in the Service Sector in Nepal- Countrywise

The following table gives the data on the FDI making countries with the amount of FDI:

Table 6.14
FDI in the Service Sector of Nepal- Countrywise
(From the Beginning to June, 2006)

(Rs. in Million)

S.N.	Country	No. of Joint Ventures	Total Project Cost	Total Fixed Cost	FDI	Percent of total FDI
1.	Australia	6	111.86	81.29	84.13	1.13
2.	Austria	2	18.98	16.22	16.48	0.22
3.	Azerbaijan	1	7.40	6.70	7.40	0.10
4.	Bangladesh	2	6.40	4.70	5.20	0.07
5.	Belgium	2	6.60	5.02	5.05	0.07
6.	Bhutan	1	5.00	2.52	1.68	0.02
7.	Bri.Virg. Is.	1	48.22	22.08	22.00	0.30
8.	Canada	3	6.28	5.24	3.78	0.05
9.	China	24	1017.18	920.87	573.23	7.71
10.	Denmark	1	3.30	1.80	3.30	0.04

11.	France	2	19.31	14.06	6.33	0.09
12.	Germany	17	243.16	208.40	76.67	1.03
13.	Ghana	1	6.50	6.18	1.95	0.03
14.	Hong Kong	5	142.03	79.35	113.57	1.53
15.	India	58	9616.99	7831.72	4090.32	55.03
16.	Iran	2	4.40	3.50	4.40	0.06
17.	Israel	1	7.50	3.25	3.00	0.04
18.	Italy	3	21.00	18.75	11.45	0.15
19.	Japan	33	495.98	410.55	153.16	2.06
20.	Malaysia	3	446.71	433.03	10.50	0.14
21.	N.Korea	1	44.82	41.20	12.55	0.17
22.	Netherlands	6	42.14	36.93	18.77	0.25
23.	New Zealand	3	4.18	2.16	2.74	0.04
24.	Norway	1	60.93	60.93	54.70	0.74
25.	Pakistan	2	12.92	9.97	12.92	0.17
26.	Philippines	1	2.50	2.00	2.50	0.03
27.	Poland	1	2.50	2.00	2.50	0.03
28.	Portugal	1	2.50	2.00	2.50	0.03
29.	Russia	4	64.97	54.56	22.26	0.37
30.	S.Africa	2	27.50	22.00	27.50	0.37
31.	S.Korea	18	209.85	160.53	157.53	2.12
32.	Singapore	4	60.07	50.80	27.55	0.37
33.	Slovenia	1	4.19	3.94	4.19	0.06
34.	SriLanka	3	79.15	55.90	37.41	0.50
35.	Sweden	1	1.70	1.40	1.70	0.02
36.	Switzerland	5	29.28	17.20	17.95	0.24
37.	Taiwan	1	50.11	40.82	10.15	0.14
38.	Thailand	1	3.00	2.70	1.00	0.01
39.	Turkey	2	8.70	5.32	8.70	0.12
40.	UK	7	92.73	80.67	91.62	1.23
41.	Ukraine	1	90.00	82.00	14.70	0.20
42.	USA	39	3392.72	3087.32	1707.42	22.98
	Total	**273**	**16521.33**	**13897.60**	**7432.81**	**100.00**

Source: DoI, GoN, 2006

The number of countries making investments in the service sector of the economy has added up to 42 up to June, 2006, as compared to 50 countries having made FDI in Nepal. The amount of total project costs and total fixed costs of FDI industries in the service sector has hit Rs. 16.5 and 13.8 billion up to June, 2006 respectively, while the total number of industries has mounted to merely 273. India alone has invested 55 percent of the FDI made in the service sector to the tune of Rs. 4.1 billion. Geographical proximity; growing markets; cultural similarity; more friendly acts and policies of Nepal towards Indians in terms of stay, ownership of property, and seeking economic activities; and the tax and custom concessions offered by the government might have encouraged the Indians to make investments in the service sector. The US stands at the second place with 22 percent. In the same way, China has contributed 8 percent. This indicates that there is vast inequality among the three countries with the higher FDI made in the service sector also, which, in economic sense, is not considered to be satisfactory. There remains a lot to do to diversify the number of countries making FDI in the service sector.

Lastly, India has the highest number of industries of 58 in the service sector. Others are USA (39), Japan (33) and China (24). Though the present state of FDI in the service sector has not been up to the expection, the potentials for its take-off in the sense of increasing the number of countries making FDI in the service sector is still immense, thanks mostly to less competition in this sector, government's incentives, growing market-size within and outside of the country with the wave of globalization i.e. rapid integration and interdependence among the economies, urbanization, acculturation, and so on.

6.4.3 FDI in the Service Sector in Nepal- Districtwise

The following table displays the data on the FDI industries in the Service Sector in various district:

Table 6.15
FDI in the Service Sector in Nepal- Districtwise
(From the Beginning to June, 2006)

(Rs. in Million)

S.N.	District	No. of Ind.	Total Project Cost	Total Fixed Cost	FDI	Percent of Total FDI
	Eastern Development Region					
1.	Morang	4	678.83	663.71	16.92	0.23
	Total	*4*	*678.83*	*663.71*	*16.92*	*0.23*

	Central Development Region					
2.	Bhaktapur	2	63.45	58.35	27.50	0.37
3.	Chitwan	1	900.00	800.00	500.00	6.73
4.	Dhading	1	60.00	55.00	0.00	0
5.	Kathmandu	197	7460.94	5429.45	3429.54	46.14
6.	Kaver	2	10.41	8.59	4.65	0.06
7.	Lalitpur	40	2416.52	2175.63	2055.86	27.66
8.	Makawanpur	2	37.79	30.66	32.16	0.43
9.	Parsa	7	55.45	38.69	32.72	0.44
	Total	*252*	*11004.56*	*8596.37*	*6081.43*	*81.82*
	Western Development Region					
10.	Gorkha	1	16.38	15.35	4.10	0.06
11.	Kaski	8	3455.40	3353.53	1086.59	14.62
12.	Nawalparasi	1	40.93	35.24	16.37	0.22
13.	Rupandehi	3	552.11	502.97	93.52	1.26
	Total	*13*	*4064.82*	*3607.09*	*1200.58*	*16.15*
	Mid-Western Development Region		–			
14.	Banke	1	90.00	20.31	10.00	0.20
	Total	*1*	*90.00*	*20.31*	*10.00*	*0.20*
	Far-Western Development Region					
15.	Achham	1	56.38	48.18	14.70	0.65
16.	Kanchanpur	1	600.00	580.00	48.18	0.81
	Total	*2*	*656.38*	*628.18*	*62.88*	*1.46*
	Undefined	*1*	*26.67*	*20.31*	*10.00*	*0.13*
	Grand Total	**273**	**16521.23**	**13897.60**	**7432.81**	**100.00**

Source: DoI, GoN, 2006.

Up to June 2006, the total number of districts with FDI in the service sector has mounted to 16 with 273 industries in all. Kathmandu has received the highest percent of 46 worth Rs. 3.4 billion. Availability of all necessary infrastructures lowering the costs of production, sense of security, easy marketing, wide access to bureacracy etc. are mainly responsible for the absorbtion of the highest percent of FDI in the service sector. The second and third place are occupied by Lalitpur with 28 percent and Kaski with 15 percent respectively. These are also the urban towns of the country. Chitwan, a urban place situated in the Terai region, has succeeded in getting 7 percent. The remaining districts receive less than 1 percent except Rupendehi with 1 percent. In this data again, 1 industry has come under the head of Undefined, which is but strange.

By the above observation, it can be concluded that the country need to focus on the development of physical infrastructures in most of the districts, before it expects to raise and diversify FDI among different districts in the service sector.

In other words, Central development region has its share of 82 percent worth Rs. 6.1 billion topping the rank, followed by the Western development region with 16 percent worth 1.2 billion. The Far-Mid Western development region has added to 2 percent to the total. The Eastern development region has the least portion of 0.2 percent of the total FDI in the service sector. This explicitly shows the prevailing inequality among the different development regions, which simply calls for special planning to reduce the undevelopment of physical infrastructures so that the FDI in the service sector can be raised, as FDI gathers where the sound infrastructures are available beforehand.

6.4.4 FDI in the Service Sector in Nepal- Yearwise

FDI in the service sector can be analyzed in terms of year. The following table gives a clear picture of FDI in the service sector made in the different years:

Table 6.16
FDI in the Service Sector in Nepal-Yearwise
(From the Beginning to June, 2006)

(Rs. in Million)

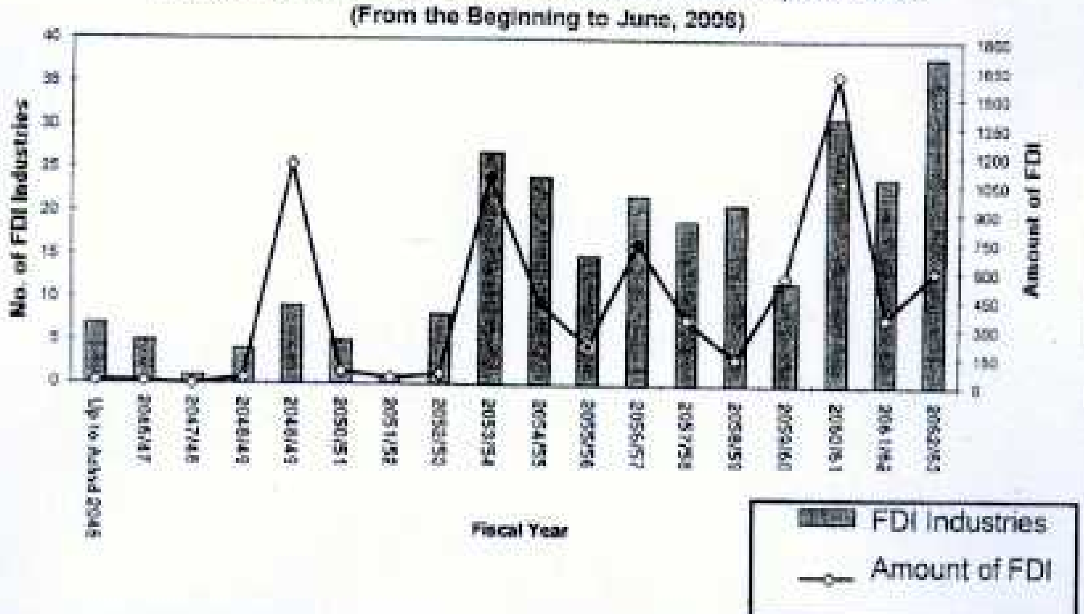
Fiscal Year	No. of Industries	Total Project Cost	Total Fixed Cost	FDI
Up to Ashad 2046	7	32.36	22.37	13.58
2046/47	5	85.97	73.55	9.54
2047/48	1	3.52	3.51	0.70
2048/49	4	124.30	117.36	31.94
2048/49	9	3548.57	3427.77	1150.56
2050/51	5	241.04	189.13	61.56
2051/52	1	31.89	31.00	31.36
2052/53	8	176.18	150.41	54.52

2053/54	27	3442.79	2398.57	1079.57
2054/55	24	1031.08	898.54	431.54
2055/56	15	487.53	445.83	201.95
2056/57	22	846.29	702.19	736.51
2057/58	19	883.28	672.32	343.08
2058/59	21	318.93	210.87	144.45
2059/60	12	987.19	858.36	565.61
2060/61	31	2241.56	2084.40	1622.35
2061/62	24	756.54	513.85	348.93
2062/63	38	1282.49	1097.57	605.08
Total	**273**	**16521.23**	**13897.60**	**7432.81**

Source: DoI, GoN, 2006.

The fluctuations can be evidedent in the FDI in the service sector over the period of 17 years. Up to Ashad 2046 (1988/89),13. 58 million had been made. The FY 2060/61 has witnessed the highest FDI in the service sector to the tune of Rs. 1.6 billion. The FY 2049/50 worth Rs. 1.2 billion. And the FY 2053/54 has witnessed the third highest FDI in the service sector. The ups and downs in the FDI in the service sector can be accounted for the law and order situation in the country in the background of the internal conflict. This trend can be presented with the aid of bar diagram in the following:

Figure 6
Yearwise Comparison of FDI in the Service Sector in Nepal-Yearwise
(From the Beginning to June, 2006)



Based on Table 6.16

The Trend Line for the FDI in the Service Sector

As in the case of overall FDI inflow to Nepal, the following Regression Model has been applied to fit the trend of the FDI in the Service Sector:

: $F_s = c + dT$

Where,

F_s = FDI in the Service Sector in Million,

T = Time Periods: 0,1,2,3, ..., 76., c & d = parameters.

With the help of the Least Square Method, the normal equations are:

$\sum F_s = Nc + d\sum T$

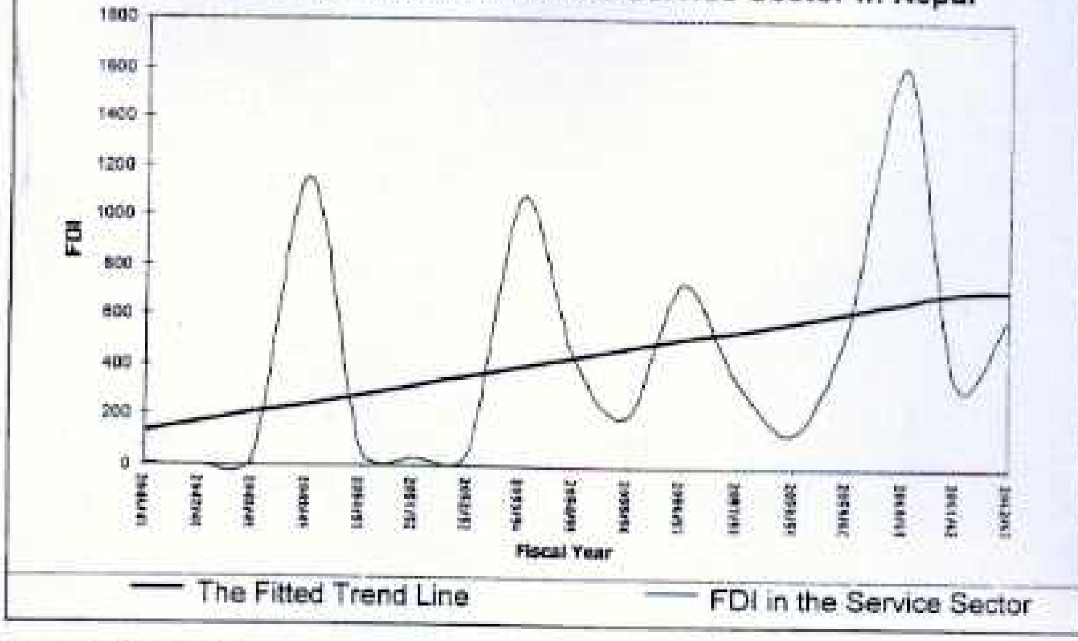
$\sum F_s T = c\sum T + d\sum T^2$

From the calculations (enlisted in the Annex 2) from the table 6, the following Regression Line has been arrived at:

$\therefore$ $\mathbf{F_s = 131.082 + 38.168\ T}$

Result. This fitted line shows that the FDI in the Service Sector has an upward trend and it has annually grown by 38.168 million rupees during the study period. The Regression Line predicts that in the FY 2063/64 (i.e. T=17) the FDI in the Service Sector will be Rs. 779.94 million. However, the parameters of the equations are statistically significant at 25 percent level of significance, shown by low value of R^2 and $\overline{R}^2$ (being 0.165 and 2.96 respectively), this prediction has very little significance in practical terms. This can be displayed in the following figure:

Fig 7
Trend Line of FDI in the Service Sector in Nepal



Based on Table 6.16

6.5 Employment Generation via FDI in the Service Sector in Nepal

The employment generation in the Service Sector through FDI has been analyzed on the basis of scale, country, district and year in the following way:

6.5.1 Employment Generation via FDI in the Service Sector in Nepal - Scalewise

The following table provides the data on the scalewise employment generation through FDI in the Service Sector in Nepal:

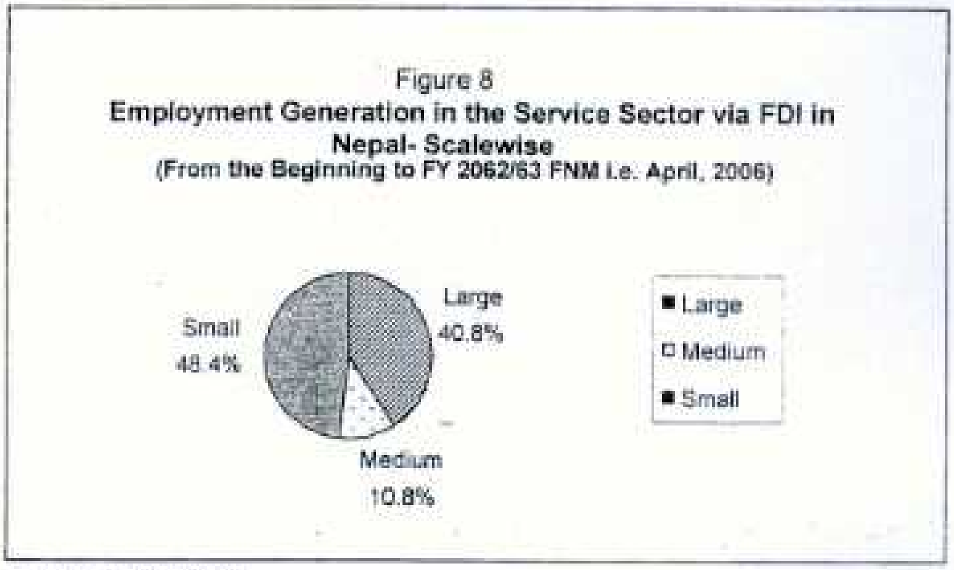
Table 6.17
Employment Generation via FDI in the Service Sector in Nepal- Scalewise
(From the Beginning to FY 2062/63 FNM i.e. April, 2006)

Scale	No. of Industry	Total Employment	Average Ind.Emp.	% of Total Employmet
Large	18	7147	397	40.8
Medium	34	1890	56	10.8
Small	213	8476	40	48.4
Total	**265**	**17513**	**66**	**100.0**

Source: DoI, Industrial Stastistics, GoN, 2006.

The large-scale industries have the highest average industry employment (397), followed by meduim-scale with 56. The small-scale, on the other hand, have the least average industry employment. What the above data imply is that the large-scale industries established in the Service Sector via FDI employ labor-intensive production technique, as compared to the small-scale ones.

On looking upon the percent of total employment borne by each industry, small-scale ones has accounted for 48 with 231 industries and large-scale ones (41) with 18 industries. The medium ones have offered only 11 percent of total employment generated by FDI in the service sector. Given the lower level of FDI in all the three scales of industries, the country needs to focus on how to attract more and more FDI, including in the service sector, to set up large-scale industries for rapid industrialization to tranform the economy into a modem one. FDI in the service sector has some unique advantages that it could help raise the standard of living of the people directy enabling them through providing various services and know-hows in the form of education and training. The above table can be presented in the following pie-chart for simplicity and precision:



Based on Table 6.17

6.5.2 Employment Generation via FDI in the Service Sector in Nepal- Countrywise

The situation of the employment generation by the FDI industries set up by different countries can be analyzed with the aid of the following table:

Table 6.18
Countrywise Comparison of Employment by JVs of Different Countries in the Service Sector in Nepal
(From the Beginning to June, 2006)

S.N.	Country	No. of Industries	Total Employment	Average Country Emp.
1.	Australia	6	59	10
2.	Austria	2	11	6

3.	Azerbaijan	1	27	27
4.	Bangladesh	2	19	10
5.	Belgium	2	62	31
6.	Bhutan	1	12	12
7.	Bri.Virg. Is.	1	0	0
8.	Canada	3	59	20
9.	China	24	943	39
10.	Denmark	1	10	10
11.	France	2	63	32
12.	Germany	17	921	0
13.	Ghana	1	0	69
14.	Hong Kong	5	345	142
15.	India	58	8231	19
16.	Iran	2	37	35
17.	Israel	1	35	28
18.	Italy	3	83	35
19.	Japan	33	950	29
20.	Malaysia	3	49	16
21.	N.Korea	1	71	71
22.	Netherlands	6	1520	253
23.	New Zealand	3	23	8
24.	Norway	1	0	0
25.	Pakistan	2	19	10
26.	Philippines	1	40	40
27.	Poland	1	38	38
28.	Portugal	1	23	23
29.	Russia	4	79	20
30.	S.Africa	2	25	13
31.	S.Korea	18	1449	81
32.	Singapore	4	111	28
33.	Slovenia	1	0	0
34.	SriLanka	3	83	28
35.	Sweden	1	6	6
36.	Switzerland	5	76	15
37.	Taiwan	1	0	0
38.	Thailand	1	0	0
39.	Turkey	2	19	10
40.	UK	7	260	37
41.	Ukraine	1	18	18

42.	USA	39	1987	51
	Total	**273**	**17763**	**65**

Source: DoI, GoN, 2006.

The highest employment has been provided by the FDI industries in the service sector from India with 8231. At the second position is USA with 1987, while Netherlands at the third position with 1520. On the other hand, Netherlands posssesses the highest average country employment of 253, followed by India with 142 and S.Korea with 81. But USA, which stands at the second position in the view of total employement, has merely 51 as per industry employment. Moreover, FDI industries in the service sector from six countries, viz. British Virginia Island, Ghana, Norway, Slovenia, Taiwan, Thailand offer no employment in the country.

6.5.3 Employment Generation via FDI in the Service Sector - Districtwise

The following table exhibits the employment generation by the FDI industries in the service sector in different districts:

Table 6.19
Districtwise Comparison of Employment Generation in the Service Sector via FDI Industries in Nepal
(From the Beginning to June, 2006)

S.N.	District	No. of Ind.	Total Employment	Percent of Total Employment
	Eastern Development Region			
1.	Morang	4	73	0.41
	Total	*4*	*73*	*0.41*
	Central Development Region			
2.	Bhaktapur	2	483	2.72
3.	Chitwan	1	718	4.04
4.	Dhading	1	0	0
5.	Kathmandu	197	12332	69.43
6.	Kaver	2	46	0.26

7.	Lalitpur	40	2672	15.04
8.	Makawanpur	2	22	0.12
9.	Parsa	7	189	1.06
	Total	*252*	*16462*	*9.67*
	Western Development Region			
10.	Gorkha	1	26	0.15
11.	Kaski	8	458	2.58
12.	Nawalparasi	1	30	0.17
13.	Rupandehi	3	69	0.39
	Total	*13*	*583*	*3.29*
	Mid-Western Development Region			
14.	Banke	1	18	0.10
	Total	*1*	*18*	*0.10*
	Far-Western Development Region			
15.	Achham	1	0	0
16.	Kanchanpur	1	605	3.41
	Total	*2*	*605*	*3.41*
	Undefined	*1*	22	*0.12*
	Grand Total	**273**	**17763**	**100.0**

Source: DoI, GoN, 2006.

Districtwise comparison of employment offered by FDI industries in the concerned sector shows that Kathmandu has the most percent of total employment, which comes as 69.43 percent with 12332. Others are Lalitpur (15.04 percent), and Chitwan (0.4 percent). The remaining districts receive less than 3 percent of total employment. The extreme concentration of few urban areas of FDI industries in the service sector in the distribution of employment is not optimal in economic sense, as the people in different districts have not been able to benefit from the FDI industries in the service sector.

6.5.4 Employment Generation via FDI in the Service Sector - Yearwise

The following table gives the data on the yearwise performance of FDI industries in the service sector:

Table 6.20
Yearwise Comparison of Employment Generation in the Service Sector via FDI in Nepal
(From the Beginning to June 2006)

Fiscal Year	No. of Industries	Total Employment	Average Year Employment
Up to Ashad 2046	7	1297	185
2046/47	5	1162	232
2047/48	1	29	29
2048/49	4	128	32
2049/50	9	1012	112
2050/51	5	253	47
2051/52	1	31	31
2052/53	8	1690	211
2053/54	27	1957	72
2054/55	24	598	25
2055/56	15	187	12
2056/57	22	498	23
2057/58	19	579	30
2058/59	21	684	33
2059/60	12	944	79
2060/61	31	1603	52
2061/62	24	3195	13
2062/63	38	1936	51
Total	**273**	**177763**	**65**

Source: DoI, GoN, 2006.

The FY 2061/62 has witnessed the highest employment offered by the FDI industries in the service sector worth 3195. At the second and third position are FY 2053/54 with 1957 and FY 2062/63 with 1936. Viewed from average year employment, FY 2046/47 stands at the first position with 232, followed by FY 2053/54 with 211. The third position is held by FY2049/50 with 112.

6.6 Technology Transfer via FDI in the Service Sector in Nepal

The following table gives the situation of technology transfer in the service sector from the beginning to April, 2006.

Table 6.21
Technology Transfer in the Service Sector in Nepal
(From the Beginning to April, 2006)

Ways of Technology Transfer	No. of Industries	Percent of Total Industries
Equity Investment	255	96.22
Equity Investment & TT	3	1.32
Technology Transfer Only	7	2.64
Total	265	100.00

Source: Reproduced from Table

Out of the total industries in the service sector set up through FDI, the highest number of industries i.e. 255 employed the equity investment, which comes as 96 percent of the total industries. Likewise, merely 3 percent of the industries i.e 7 has adopted technology transfer only. equiy investment and technology transfer has been employed by meagre percent of 1. This gives a gloom picture of technology transfer in the service sector. The difficulties in bringing in technology caused by administrative hassles, lack of skilled manpower for the installment, operation and limited profitability has lowered the number of industries adopting technology transfer.

CHAPTER VII
FINDINGS AND RECOMMENDATIONS

7.1 Major Findings

In the global context, the capitalist and the socialistic countries alike have been on the race to attract more and more of FDI for a long time. This trend has been further intensified with the wave of globalization in the later half of the 20th century encompassing the developing countries also.

Realizing the significant role of FDI in the economic development of the country through industrial revolution, Nepal started its journey to attract FDI during the Sixth Plan (1980-85) with the Industrial Policy (1981), aimed at creating a foreign investment friendly environment in the country. However, in 1992, a host of acts and policies were put into practice by the people's elected government following the *Jana Andolan (1990)*. These acts and policies include Industrial Enterprise Act 1992; One Window Policy 1992; Industrial Policy 1992; and Foreign Investment and Technology Transfer Act 1992, which have been receiving some amendments henceforth. These extant policies and acts, indeed, have a number of provisions to attract more FDI into the country.

The present study, having employed the data until 11 June, 2006, has come to some major conclusions. The total number of FDI industries has reached 1087 to date with the total Fixed Costs of Rs. 77.1 billion and the total Project Costs of Rs. 93.1 billion. Of the total FDI from the beginning having amounted to Rs. 28.8 billion, the manufacturing sector has received the highest share in the total FDI, followed by the service and tourism and energy-based sector, while the mineral sector is the least FDI receiver. The year wise trend of FDI gives a picture of fluctuations, the reason being the cumulative impact of the political instability; the emergence of the Maoists' insurgency; direct rule of the King etc. at large which confined the economic activities in the economy utterly to a halt. Among the 50 countries making FDI in the country, India stands at the first position, with the USA in the second and Britain Virginia Island in the third position. The seven countries making the highest FDI in Nepal- viz. India, USA, Britain Virginia Island, China, Norway, Japan and South Korea- accounts for more than 80 percent of the Total FDI. Around 9 percent of the FDI industries have either closed their operation or cancelled, indicating an alarming situation. Likewise, among 42 districts with the FDI, Kathmandu, the capital of the country, has managed to grab the most share of the total FDI, followed by Lalitpur and Kaski- all having in the urban areas.

In the perspectives of employment opportunities generated through FDI, the manufacturing sector has created the highest percent of employment from the beginning, while the mineral based sector has managed to generate the least employments. Kathmandu again has obtained the highest percent of total employment generated through FDI. Considering the technology transfer, equity investment is found to be widely employed by the FDI industries in Nepal.

In the case of the Service Sector, the total number of FDI industries in the Service Sector has reached 273 up to June, 2006 with the total FDI of Rs. 7.4 billion, whereas the total project costs and total fixed costs have hit Rs. 16.5 and 13.9 billion respectively. The total number of the countries making FDI in the service sector has added to 42, showing that 8 countries making FDI in the country has not mâde any investments in the service sector. India has made the highest FDI in this sector, followed by USA and China. As in the overall FDI, the seven countries with the highest investments in the service sector- viz. India, USA, China, Britain Virginia Island, Norway, Japan, South Korea- has accounted for around 90 of the Total FDI in the Service Sector. Out of 16 districts with FDI in the service sector, Kathmandu as usual has received about fifty percent of total FDI. Indian firms have offered the highest employments. As is the case of overall FDI, Kathmandu has got around 70 percent of total employment generated through FDI in the service sector. Equity investment as in case of overall FDI is also found to be widely used in the FDI industries in the Service Sector.

The study has found out that from the formation of the first elected government following the People's Movement (1990), popularly known as *Jana Andolan I* to the April Revolution (2006), aka *Jana Andolan II*, basically the liberalization policy sought by the country and the incentives offered by the government have made a positive and significant impact in raising the level of FDI inflow, including the FDI in the service sector. However, the level of FDI in general and FDI in particular has not been satisfactory. The another major finding is that the problems and prospects of both overall FDI and the FDI in the Service Sector in particular has been ,more or less, similar.

From the analysis of the data relating to overall FDI, the measures necessary for the problem of FDI in Nepal are: formulation of a clear vision of the GoN on FDI policy, the utilization of economic diplomacy, rapid development of infrastructures, amendments in the present Labor Act to make it more flexible, setting up of more Export Processing Zones (EPZs) and Special Economic Zones (SEZs), priority to technical and vocational education, establishments of more Research and Development (R & D) institutions to tap the vast unused natural resources, emphasis on the hydroelectricity generation in larger scales and special provision to invite investments of NRNs. Similarly, integration of the national economy with global economy, carrying out the liberalization of the economy in faster pace, more attractive and timely incentives packages to the foreign investors through legal improvements and simplification of the entry and exit process with the effective operation of One Window Policy.

7.2 Recommendations

The present study has made the following recommendations in order to address the promotion of FDI in the Service Sector:

1) **Clear Policy and Effective Implementation.** The first and the foremost, the government should make a clear vision for the promotion of FDI in the areas, for instance, areas in the service sector open for FDI; tax-rates; exit policy; repatriation rights; transfer of technology; other facilities and so on, considering the far-reaching effects. The debate on whether FDI in the newspaper (and the media sector) in Nepal should be allowed to take place some year back is the testimony to the fact that the Nepalese policies regarding FDI open areas in the service has not been comprehensive. Moreover, Nepal should improve the legal provisions for FDI with the intent to make these policies compatible with the regional and international economic organization and agreements such as WTO and SAFTA. In the same way, the government should labor hard to implement the acts and policies strictly. At present, the government should effectively implement the One Window Policy to facilitate the foreign investors.

2) **Infrastructural Development.** Nepal should concentrate on the development of necessary physical infrastructures, as it plays a pivotal role in the promotion of FDI in the service sector. The government can speed up the infrastructural development with the participation of private sector in line with the evolving concept of Public Private Partnership (PPP). But care should be taken whether infrastructural development has been balanced in all the regions.

3) **Economic Diplomacy.** To raise the publicity of the areas of the Service Sector open for FDI in Nepal in the international arena, Nepal can make use of economic diplomacy, which means the utilization of the ambassadors and other government envoys stayed in the foreign lands for the realization of economic benefits of the country and is a pragmatic means for the promotion of FDI

ensuring the better allocation of public resources. This will increase the FDI in the Service Sector in a considerable manner.

4) **Development of Energy-Sources.** As the FDI industries in the service are likely to face the serious shortages of energy, Nepal should accord top priority in the development of big hydroelectricity which possesses the comparative advantages over other sources of energy. However, other sources of energy like solar, wind, coal and other gases can be advanced.

5) **Flexible and Relevant Labor Act.** The prevailing labor act, considered to be a hindrance to the utilization of the vast labor-force, should be reviewed so as to make it more flexible and investment-friendly.

6) **Re-orientation of the Present Education System towards Vocational and Technical one.** Nepal should make it education system more vocational and/or technical with a view to meet the ever-growing demand of skilled manpower and expertise of the FDI industries in the Service Sector. The set-up of government training institutes in large number is the need of the hour.

7) **Attractive Incentive Schemes.** Nepal should immediately offer attractive incentive schemes in line with that of India and China for the rapid growth of FDI in the Service Sector, as the FDI flows towards where more incentives are provided.

8) **Liberalization of the Economy.** Nepal can not remain in isolation in the present age of globalization. That is why Nepal, for nearly two decades, has been adopting the policy of liberalization but it has been in a snail's pace. As the liberalization policy is found to make a great role in attracting more FDI in this sector, this should be followed with a greater speed, abolishing the rigidities in the market due to the presence of government monopolies through the privatization drive.

9) **Establishment of a Strong Data-Recording Agency.** Though the government has been collecting the data regarding the FDI industries in the country, most of the data have not been found up-to-date. This has greatly caused difficulties to the foreign investors. Morever, the researches and academicians of the country have been facing paucity of necessary and relevant data for conducting researches to find ways for further improvements for attracting more amount of FDI.

10) **Good Governance.** Nepal should ensure the foreign investors that good-governance is strictly practized in the country. Therefore, any government in the country should follow the spirit of the good-governance to build business confidence among the foreign investors, which consequently will lead to a rapid rise of FDI in the Service Sector.

11) **Tapping the Investements of NRNs.** The Non-Resident Nepalese (NRNs) have for a long been demanding some facilities from the government to commence their business in the country. Therefore, the government should pay due attention in tapping the vast investment of NRNs.

12) **Facilitation in the Import of the Necessary Machinery Equipments and Spare-parts.** Nepal needs technology transfer to convert its traditional economy into a modern one. For this to happen, the country should simplify and give concessions in the import of necessary machinery-equipments and spare-parts.

13) **No Political Intervention to the FDI Industry in the Service Sector.** The government should immediately avoid exercising any sort of political intervention to the FDI industries to create the conducive business environment in the economy.

14) **Development of Indigenous Business Community.** As foreign investors are found to take the development of indigenous business community as a measuring rod to gauge the profitability in the economy. If there is no local

entrepreneur in a sector, foreign investors consider the low rate of profitability in that sector. So, the government should create conducive environment for local entrepreneurs before expecting the foreign investors to invest in the Service Sector of Nepal.

15) **Simplification of the 'Entry and Exit' Policy.** As per the complaints of the foreign investors, the government should simplify the entry and exit policy for an FDI industry in the Service Sector.

7.3 Need for Future Research

The present study is mainly concerned with general analysis of overall FDI inflow to Nepal and the FDI in the Service Sector in particular. However, owing to resources (fund and time) constraints, the scope of the research has somewhat limited, as it has not covered all the FDI industries and the FDI industries in the Service Sector throughout the country. Therefore, to explore knowledge on the impact -- positive as well as negative also-- of FDI industries including those in the Service Sector, FDI movating factors (economic as well as noneconomic), problems faced by the FDI industries and recommend suggestions to combat the problems facing them, an extensive follow-up study that incorporates all the FDI industries existing in all the sectors of the economy is felt urgently necessary to find new ways to take a quantum leap by attracting heavy influx of FDI in the present era of globalization.

Annex 1
A Regression Model for Overall FDI

The Required Regression Equation: $F = a + bT$ .... (1)
Where, F = FDI in billion, T = Time Periods: 0,1,2,3, ..., 16, a & b = parameters

The normal equations of equation (1) are:
$\sum F = Na + b\sum T$ .... (2)
$\sum FT = a\sum T + b\sum T^2$ .... (3)

Upon substition,
$28.40 = 17a + 136b$
$258.56 = 136a + 1496\ b$

This gives;
$a = 1.055$ & $b = 0.077$

The Required Regression Line:
$\therefore \mathbf{F = 1.055 + 0.077\ T}$ .... (4)

1. The Unadjusted Coefficient of Determination (R^2)

$$\left(R^2\right) = \frac{b\sum ft}{\sum f^2}$$

From the data,
$\sum ft = \sum FT - n(\bar{F})(\bar{T}) = 31.30$
$\sum f^2 = \sum F^2 - n(\bar{F})^2 = 12.35$

$\therefore \mathbf{R^2 = 0.196 \approx 20\%}$

2. Adjusted $\bar{R}^2$
$H_0 : b = 0$
$H_1 : b \neq 0$
ANOVA Table

Sources of Variation	Sums of Squares	Degree of Freedom	Mean Square Error	F-ratio
Due to Regression	2.42	1	2.42	
Residual	9.94	15	0.66	F = 3.67
Total	**12.35**	**16**		

F at 10% level of significance, $F_{(1,15)} = 3.07$ ....*Significant: H_1 accepted.*
Result: This implies that the fitted regression line for overall FDI has a less degree of forcasting capaciy.

Annex 2
A Regression Model for FDI in the Service Sector

The Required Regression Equation: $F_s = c + dT$ .... (1s)
Where,
F_s = FDI in the Service Sector in million, T = 0,1,2,3, ..., 16., c & d = parameters.

The normal equations of equation (1s) are:

$\sum F_s = Nc + d\sum T$ .... (2s)

$\sum F_s T = c\sum T + d\sum T^2$ .... (3s)

Upon substition,

7419,25 = 17c + 136d

74926.72 = 136c + 1496d

This gives; c = 131.082 & d = 38.168

The Required Regression Line:

$F_s = 131.082 + 38.168\ T$ .... **(4s)**

1. The Unadjusted Coefficient of Determination (R^2)

$$\left(R^2\right) = \frac{d\sum fst}{\sum f^2 s}$$

From the data,

$\sum f_s t = \sum FT - n\,(\overline{F}_s)(\overline{T}) = 15572.24$

$\sum f_s^2 = \sum F^2 - n\,(\overline{F}_s)^2 = 3608212.87$

$\therefore$ **R^2 = 0.165 ≈ 17%**

2. Adjusted $\overline{R}^2$

$H_0: b = 0$

$H_1: b \neq 0$

ANOVA Table

Sources of Variation	Sums of Squares	Degree of Freedom	Mean Square Error	F-ratio
Due to Regression	594361.26	1	594361.26	
Residual	3013851.61	15	200923.44	F
Total	**3608212.87**	**16**		= 2.96

F at 25% level of significance, $F_{(1, 15)}$ = 1.43.......*Significant: H_1 accepted.*

Result: This implies that the fitted regression line for FDI in the service sector also has a very less degree of forcasting capacity.

Annex 3

National Priority Industries for FDI in Nepal

1. Agro- and Forestry-based Industries.
2. Engineering Industries (Producing Agricultural and Industrial Machine)
3. Industry Manufacturing Fuel Saving or Pollution Control Devices.
4. Solid Water Processing Industry.
5. Road, Bridge, Tunnel, Ropeway and Flying Bridge Constructing and Operating Industry.
6. Hospital and Nursing Home (Only Outside the Kathmandu Valley).
7. Industries Producing Ayurvedic, Homeopathic and Other Traditional Machine and Industries Producing Crutch, Seat Belt, Wheel Chair, Stretcher and Stick and so on to be used in aid of the disabled or the orthopaedic.
8. Cold Storage installed for the Storage of Fruits and Vegetables.

Source: The Industrial Enterprises Act, 1992.

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LINKS

1.	International Monetary Fund (IMF)	*http://www.imf.org*
2.	UNCTAD	*http://www.unctad.org*
3.	World Bank (WB)	*http://www.worldbank.org*
4.	World Trade Organization (WTO)	*http://www.wto.org*
5.	Nepal Rastra Bank (NRB)	*http://www.nrb.org*

Other Auxiliary Links:

1. *http://www.cipe.org*
2. *http://www.economicswebinstitute.org*
3. *http://www.southcentre.org*
4. *http://www.oecd.org*
5. *http://www.financeindiamart.com*
6. *http://www.oxford-conference.com*
7. *http://en.wikipedia.org*
8. *http://www.ssc.upenn.edu*
9. *http://www.moneymattersinstitute.org*
10. *http://www.wakeupcall.org*

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