Foreign Direct Investment

Towards Second Generation of Reforms

Dr. Bhola Nath Chalise,
Pramod Rijal, Vivek Nath Pyakuryal & Akash Shrestha

Published by
Samriddhi, The Prosperity Foundation

Foreign Direct Investment
Towards Second Generation of Reforms

Dr. Bhola Nath Chalise,
Akash Shrestha, Pramod Rijal & Vivek Nath Pyakuryal

July 2013

Published by
Samriddhi, The Prosperity Foundation

Published by
Samriddhi, The Prosperity Foundation
P. O. Box: 8973, NPC 678
416, Bhimsengola Marga, Minbhawan Kharibot
Kathmandu, Nepal

Tel. : (+977)-1-446-4616, 448-4016
Fax : (+977)-1-448-5391

E-mail: info@samriddhi.org
Website: www.samriddhi.org

ISBN: 978-9937-8680-8-2

First edition: July 2013

Price: NRs. 200/-

Contents

About the Authors

Dr. Bhola Nath Chalise

Dr. Bhola Nath Chalise is a renowned economist of Nepal. He has served at various significant positions in the government such as Chairman of the largest commercial bank of Nepal, Rastriya Banijya Bank, Managing Director of Nepal Electricity Authority, Member Secretary of National Planning Commission, and Secretary of Ministry of Local Development among others. He has also served as the Under-secretary, Joint-secretary, and Secretary of Ministry of Industry for a period of 16 years, playing a vital role in formulating several policies, including the Industrial Enterprise Act 1992, Foreign Investment and Technology Transfer Act 1992, and others.

Pramod Rijal

Mr. Rijal is a Research Associate at Samriddhi, The Prosperity Foundation. Before joining Samriddhi, he was involved in several research related works at Nepal Development Watchdogs (NDW), United States Institute of Peace (USIP) and National Economic Concern Society (NECS), Nepal. He is also a teacher of Economics at Campion College and Ed-Mark College and has contributed a number of articles in various national dailies. He co-authored a book (with Dr. Kamal Raj Dhungel) called "Investment Prospects & Challenges for Hydropower Development in Nepal" which was published by Samriddhi Foundation in 2012.

Vivek Nath Pyakuryal

Vivek Nath Pyakuryal is a Researcher at Samriddhi, the Prosperity Foundation. He holds a Masters degree in International Relations from the University of Melbourne, Australia. He has worked as a tutor at the Nepa School of Social

Sciences and Humanities and as a researcher for Nossal Institute for Global Health, Melbourne. He is currently undertaking independent research in the field of political science and aims to attain his doctorate soon.

Akash Shrestha

Mr. Shrestha is a Research Assistant at Samriddhi, The Prosperity Foundation. He was one of the founding members of the Nepal chapter of Youth for Nepal (YFN), a New-York based non-profit, working to create social entrepreneurs out of Nepali youth in the fields of health, education and environment. Prior to joining Samriddhi, he has also been involved with Himalayan Bank Ltd. as an intern. Currently, he is a final semester student of Bachelor of Business Administration (BBA) at Kantipur College of Management and Information Technology (KCMIT) under Tribhuwan University.

Acknowledgement

This research paper "Foreign Direct Investment: towards second generation of reforms" covers one of the six cross-cutting issues identified during the sectoral analysis conducted by Samriddhi Foundation in collaboration with Federation of Nepalese Chambers of Commerce and Industry (FNCCI) under the banner of 'Nepal Economic Growth Agenda (NEGA)' during 2011/2012. We would like to thank the people who were directly and indirectly involved in the process of preparing the paper. We are highly appreciative of our research guide Dr. Bhola Nath Chalise for giving definitive direction to this research as well as for directing us to the available literature and resources. We would also like to thank Pramod Rijal, Akash Shrestha and Vivek Pyakuryal for preparing this paper. We would also like to thank Shreeya Neupane for helping us during the conceptualization of the paper.

This study has gone through extensive consultations in Kathmandu and we are extremely grateful to the individuals who gave us their valuable time to participate and provided us with their invaluable knowledge and feedback. We would like to acknowledge Dr. Nar Bahadur Thapa, Director, Nepal Rastra Bank, Mr. Sashi Sagar Rajbhandari (Former Director of Nepal Electricty Authority), and Mr. Tika Rai (Magnus Consulting Group) who gave us their time and valuable expertise and feedback during individual consultations.

The encouragement shown by the business community, government officials, experts, practitioners and other people whom we met during the process has also been instrumental in helping us to continue with the long and rigorous process of the study. Finally, we would like to give special thanks to the team at Samriddhi for their continuous encouragement and support.

Samriddhi, The Prosperity Foundation
July 2013

Preface

As part of its efforts to raise economic agendas in Nepal, Samriddhi Foundation is committed to an annual analysis of constraints of economic growth of Nepal along with exploring policy options. This process, termed as the 'Nepal Economic Growth Agenda (NEGA)', is an annual effort to identify short term as well as long term policy bottlenecks that hinder Nepal's economic growth. This research paper, 'Foreign Direct Investment: Towards Second Generation of Reforms', prepared as a follow up to NEGA 2012 is one of the six cross-cutting issues covered under NEGA 2013.

NEGA 2012 identified and discussed policy constraints in five growth sectors of Nepal viz. Agriculture, Education, Hydropower, Transport Infrastructure and Tourism. Building on this research, NEGA 2013 focuses on identifying and discussing cross-cutting issues that affect the growth of all five sectors and also makes recommendations to address these issues. The goal of these analyses and papers is to facilitate the creation of a competitive and conducive business environment in Nepal, thereby leading to economic growth and prosperity.

The six different issues studied under NEGA 2013 are Industrial Relations, Contract Enforcement, Anti-Competitive Practices, Foreign Direct Investment, Public Enterprises, and Regulatory environment for businesses. Each research paper has been prepared in consultation with individuals and groups who are experts or are involved in the particular field.

The six issues studied under NEGA 2013 have been presented as individual research papers that will be combined and presented as NEGA 2013 towards the end of 2013. This research paper on Foreign Direct Investment was prepared by the team of Dr. Bhola Nath Chalise, Mr. Pramod Rijal, Mr. Vivek Pyakuryal, and Mr. Akash Shrestha.

The first generation of reforms in foreign direct investment took place in the form of Foreign Direct Investment and Technology Transfer Act of 1992. This act sought to ease up the process of FDI in Nepal focusing on entry and exit mechanisms. It also opened up several sectors previously barred from FDI while maintaining a small negative list. However, it has been more than twenty years since this reform and owing to the growth of FDI in emerging markets especially in Asia, it is time for Nepal to embark on the second generation of reforms. This paper is an attempt to identify challenges that Nepal faces in terms of attracting FDI and to develop a framework for the second generation of reforms.

Nepal's primary challenges are in its business and regulatory environment. Faced by infrastructural bottlenecks and an unstable policy environment, Nepal needs a highly competitive regulatory structure to be able to entice growth producing FDI. Given the political economy context of Nepal, there are high chances of attracting FDI that only enhance extractive institutions. Therefore, the focus of this paper is on reform areas that ensure FDI actually trickles down and helps through creation of jobs and capital formation.

The paper is based on in depth consultations with various stakeholders and experts. It contains historical analysis and also highlights key policy bottlenecks. The paper has attempted to provide a broad framework of guiding principles for the second generation of reforms for FDI.

Abbreviations and Acronyms

BITs	Bilateral Investment Treaties
BIPPA	Bilateral Investment Promotion and Protection Agreement
BoP	Balance of Payment
DoI	Department of Industry
FDI	Foreign Direct Investment
FITTA	Foreign Investment and Technology Transfer Act
GATS	General Agreement on Trade and Services
GATT	General Agreement on Trade and Tariff
GDP	Gross Domestic Product
GDS	Gross Domestic Savings
GoN	Government of Nepal
IT	Information Technology
LDC	Least Developed Country
MoAC	Ministry of Agriculture and Cooperatives
MoI	Ministry of Industry
MW	Mega Watt
NEGA	Nepal Economic Growth Agenda
NIB	Nepal Investment Board
NRN	Non Residential Nepalis
ODA	Official Development Assistance
PDA	Power Development Agreement
PTA	Power Trade Agreement
SDTs	Special and Differential Treatments
SJVN	Satlaj Jal Vidyut Nigam
SMEs	Small and Medium Enterprises
SNP	Statkraft Norfund Power
TRIMs	Trade Related Investment Measures

UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

The Nepali year is based on the Bikram Sambat Calendar and is approximately 57 years ahead of the Gregogrian calendar (2062/1/1=2005/4/14)

1. Introduction

Foreign Direct Investment (FDI) is defined as cross-border investment done by foreign companies in a host country. It does not include investments made in the stock market. There are generally two ways through which a company can make direct investments in a host country. A company can either buy a company located in the host country and make the company its wholly owned subsidiary or start a joint venture with current owners. Companies venture into foreign investment in another country in order to take advantage of markets, efficiency, resources and strategic asset (Ramkishen, 2004).

Before the wave of liberalization in Nepal in 1992, investment coming into Nepal predominantly came in the form of foreign aid also known as official development assistance (ODA). Nepal has been receiving foreign aid since World War II (Chaulagain, 2012). Since the late 1970s, the western international donor community started making their aid programs conditional—sometimes in the garb of structural adjustment policies and sometimes behind the veil of good governance. At the same time, bilateral donors saw aid as being vital for the survival and stabilization of regimes in which they had strong political interests (Gautam, 2012).

As a developing economy, Nepal realized the importance of attracting investment and new technology to be able to utilize its existing natural resources and growth potential. Development aid helped build infrastructure and served many social welfare functions but was not able to prompt the economy as profit motivated investment could. Nepal took on a liberalization strategy in the early 90s. Foreign Investment and Technology Transfer Act (FITTA) 1992 came into place to encourage FDIs into the country and The Foreign Investment and Technology Act, 1981 was repealed.

Nepal has good investment prospects in hydropower, tourism, agriculture, and information and technology. There is huge potential in the hydro-power sector of the country with a feasible generation capacity of 42,000 MW. Thousands of Nepalese students travel abroad in pursuit of higher education and spend billions of rupees every year. At the same time, over a million students from India and China combined travel abroad for their higher education. Similarly, a huge number of the youth workforce flies off to foreign countries for employment. However, we have still not been able to tap into our resources and opportunities to trigger economic activities in the country. There is a lack of capital, skilled human resource, and modern technology to trigger economic activities in the domestic market. Hence, there is an urgent need to bring in FDI to Nepal.

FDI and economic growth have a strong relationship. FDI has the ability to endow a sustainable high trajectory of economic growth to a host country (Sanderatne, 2011). The investments that come in through the FDI channel are risk-free sources of investment to the country. Along with capital, FDI brings in advanced technologies and management practices. The value added in these sectors is a direct input to the gross domestic product (GDP) and thus speeds up the growth of GPD. It increases employment opportunities which leads to an increase in the growth rate of industries in the country. FDI reduces the expenditure needs of the government as foreign investors with huge cash reserves themselves invest in the back-end infrastructure of that country in order to improve it according to their own business needs.

The current regime that governs foreign direct investment has primarily focused on reducing the entry costs for foreign firms investing in Nepal. This focus is too limited to unleash the potential for FDI inflows into the country and to truly reap the benefits of FDIs. To effectively compete for FDI with countries like Vietnam, Cambodia, Bangladesh and such, more detailed reforms are needed. The comparative study of Vietnam and other South Asian nations is given in Annex 1. The purpose of this study is firstly to highlight lucrative areas for foreign direct investment in Nepal, and secondly and more importantly, explore factors that would need to be taken into consideration for second generation reforms that tackle wider issues of foreign investment (focusing on factors more than exit and entry). The report ends with recommendations on what these second generation reforms could potentially encompass.

2. Prospects of FDI in Nepal

Hydropower is one of the areas with immense potential to attract FDI. Nepal's hydropower sector has been attractive to FDI particularly after the construction of the large Khimti and BhoteKoshi hydropower projects that were funded primarily by foreign investment. Out of the estimated hydropower generation potential of 83000 MW, 42000 MW is economically viable (Investment Climate Statement-Nepal, 2012). Only a very small amount of it has been utilized leaving huge untapped potential for hydropower energy. According to the Nepal Economic Growth Agenda, 2012, there is a deficit of 520 MW of electricity during the winter season and people have to live under loadshedding for several hours a day. The current production has not even met local demand. With adequate transmission, the limitations to which will be discussed later in the paper, hydroelectricity produced in Nepal can cater to the growing energy demand of neighboring countries. This gives foreign investors a great locational advantage for investing in energy to supply to rapidly growing India and China. Nepal's hydropower potential can also act as a strategic asset for India as most of its populated states are located in northern region which is close to some of the mega hydropower projects such as West-Seti (750 MW) and Karnali Chisapani (10,800 MW) that are situated in the south-western part of Nepal. These sorts of storage type projects also help reduce floods and landslides in both countries because water is stored during the rainy season in mega dams and released during the winter seasons. It also helps irrigate the land of Nepal and India which in return helps increase agricultural production.

Nepal has locational benefits for FDI in agricultural production[1].

1 For a detailed discussion about locational advantage as a determinant of FDI inflows see Dunning, 1997.

This advantage largely comes from Nepal's climatic condition, topography and access to the growing and densely populated markets of its neighbors. Nepal is suitable for cultivation of organic seeds, vegetables, fruits, and flowers. It also has scope for eco-tourism and agro-tourism, recent concepts that have been growing successfully. Agro-tourism and eco-tourism would work in developing new tourist destinations as well as providing lucrative farming opportunities. Places like Kanyam are classic examples where both of these opportunities have been developed. Structural adjustment programs and the adoption of liberal economic policy have decreased public funds in this sector, leaving a large space for private or foreign investment in the agriculture sector. In order to encourage investment in Nepal, the government has formulated favorable investment policies for this sector (MoAC, 2012). Due to these reforms, the past few years has already seen some rise in FDI inflow in agriculture. These investments, however, are of small scale due to other policy hurdles in agriculture commercialization in Nepal. Due to the potential for growth, and following favorable policies, this sector has much to offer to foreign investors.

In the field of education, the potential of FDI is very high because of the large market that is available in Nepal. Many Nepalese students go to India, China, Australia, the USA, and the UK for higher education every year. In the fiscal year 2010/11, over 27,000 Nepalese students took the 'No Objection Letter' to study abroad (The Himalayan Times, 2011). This figure does not include the students going to India for higher education. This large potential market is a strong incentive for investment, particularly by foreign firms involved in education, to invest in higher education in Nepal (Ramkishen 2004). In addition, if Nepal can develop quality education standards, then it will also be able to attract the growing number of Indian and Chinese students as it has an added attraction of favorable climatic conditions and touristic destinations.

The Information Technology (IT) field also has high potential in Nepal. With a growing number of IT graduates and the global IT industry looking for cost effective outsourcing, Nepal can develop as the next destination for global IT companies. Another attraction of IT industry in terms of FDI is the low requirement of capital investment. Even a couple of thousand dollars can be the basis of a successful industry. Therefore, first time investors do not necessarily have to risk large investments in this sector.

There is high potential for investment in the tourism industry as well. After the end of the decade long armed-conflict in Nepal, the prospect of peace has brought about an increase in the number of tourist arrivals in Nepal. As new tourist sites are constantly being discovered, there is high demand for quality hotels, lodges, and restaurants. However, Nepal lacks the absorption capacity in terms of tourist spending. There is significant space to increase the average expenditure and duration of stay with provisions of proper facilities, infrastructure, and activities. In addition, with the increase in disposable income of Indian and Chinese tourists- which constitute a major share of tourism in Nepal –there are immense prospects for growth in this sector (Manju, 2012). Due to Nepal's unique topography and ecology, and various new tourist attractions opening across the country, this sector would also be attractive to foreign investors looking to invest in new and upcoming niche markets.

At the policy level, Nepal has formulated a liberal and open Foreign Direct Investment and Technology Transfer Act 1992 with a limited negative list. It has opened more sectors of the Nepalese economy for foreign investment with the guarantee of non-nationalization, repatriation of profit, share transfer, and dividend sharing. The government of Nepal has also opened various implementing institutions such as Industrial Enterprise Development Institute (IEDI), National Productivity and Economic Development Center (NPEDC), and Industrial Estate Management Limited (IEML). These organizations have been designed with the objective of effective policy implementation, industrial sector promotion, and institutional strengthening and managing problems of private sectors. In addition to this, Nepal has also signed Bilateral Investment Protection and Promotion Agreements (BIPPA) with the following six countries in chronological order – France, Germany, UK, Mauritius, Finland and India (Paudyal, 2013). It has covered the provision which provides compensation to the investors whose investments suffer losses due to war, armed conflict, and a state of national emergency. These are all positive steps towards encouraging FDI into the country. Each sector faces specific challenges to bringing in FDI.[2] However, as stated above, there is a need for further reform if Nepal is to truly exploit its potential for FDI. The next section delves into these reform considerations.

2 For a detailed discussion of major challenges that each sector faces, refer to Annex 2.

3. The Reform Agenda

An FDI policy regime, while targeting maximum FDI inflow, must also adhere to other obligations and limitations that the country has, based on its legal regime and international relations. With the liberalization efforts through FITTA, 1992, Nepal has already undertaken its first generation of reforms. This reform concentrated on opening up Nepal for FDI in various sectors and easing the entry and exit regulations. Nepal now needs a second generation of reforms. There are several factors that need to be considered for this generation of reforms.

3.1 Bilateral Agreements

Neumayer and Spess (2005) examined whether signing bilateral investment treaties (BITs) increases FDI inflows and concluded countries which have signed BITs have higher FDI inflows. They argue that BITs are able to address "dynamic inconsistencies" which arise when a host country initially committed to providing "fair and equitable treatment" to foreign investors shies away from its promise once the investment is undertaken. Neumayer and Spess find that domestic legislation may not be as binding a device as a BIT. They argue that signing a BIT will not only affect FDI from the particular signatory country, but that it will act as a signal to other foreign investors, indicating that the host country is seriously committed to safeguarding established foreign investment. However, there is some consideration of the effect of bad institutional quality on the ability of bilateral treaties to increase FDI inflow. There is only limited evidence that BITs may act as substitutes to bad institutional quality. Lack of a working bilateral agreement that has hampered foreign investment can be seen in the hydropower sector. Some international investors are seriously committed to harnessing hydropower in Nepal and exporting electricity to India, as electricity generated from such mega projects will result in a surplus even after meeting domestic demand. These companies could not start their construction work due to the absence of Power Trade Agreement (PTA) between India and Nepal and a commodity tax of 2% charged by India on electricity exported from Nepal. Similarly, the availability of a market is an incentive for investors. Nepal is close to India, which is a very large market. If Nepal's bilateral agreement on trade and transit can be revised, it would open up avenues for investment in the trade sector as well.

3.2 Business Environment

Any efforts at encouraging foreign investment should take into consideration the prevailing business environment. A conducive business environment has been cited by many as one of the key factors that determine FDI inflows into the country (see Asiedu 2000; Ramkishen 2004). In our analysis of the five sectors, we have found poor business environment to be a cross cutting problems. Nepal ranked 108th out of 185 economies on the Ease of Doing Business (World Bank, 2013). The policy side looks open and liberal for foreign investors but a lot of implementation challenges such as red tape, corruption, and delays in approval have been encountered. Therefore, we look at several aspects of the business environment in this section that are imperative to increase FDI inflows. Included in this section is the process of liquidation, repatriation, issues of land acquisition, increased cost of transactions, infrastructure, government policies, and political instability. There is much work that needs to be done to create a favorable business environment for investors.

3.2.1 Increased Cost of Transaction

"Hassle costs" in the form of administrative barriers and red tape is said to dampen a country's general investment environment (Ramkishen, 2004). High cost of transaction is another factor most authors have highlighted as being critical to firms when deciding to invest in foreign countries. There are various bureaucratic hassles that discourage potential investors to start their business ventures in Nepal. In addition to the red tape problem, rampant corruption contributes to increase in the transaction cost of doing business. In the Corruption Perception Index produced by Transparency International, Nepal ranks 139th out of 174 countries (Transparency International, 2012). In addition to this, getting approval for FDI is also lengthy and cumbersome. That is why most Non-Resident Nepalese (NRN) bring money via hundhi (illegal transfer of money into the country) and invest in their projects. Money transfers through these channels do not reflect the true financial position of a country. Besides this, financial institutions lose a large amount of money that can be earned in the form of service and other fees (Rijal, 2013). High transaction costs are reflected in the Economic Freedom of the World Index's country analysis of Nepal. In a ranking scale where 10 is the most preferred and 0 the least preferred, 'Administrative Requirements' in Nepal is given 2.81, 'Extra payment/bribes/favoritism' is given 2.89 and 'Bureaucracy costs' is given 7.06 (Gwartney, Lawson, Hall 2011, p. 119).

3.2.2 Land Acquisition

The Land Act of 1964 has not ensured productive and commercial use of state owned land. It is very difficult to establish any kind of large scale industries in Nepal, unlike Vietnam and Myanmar where such provisions are provided. Likewise, it is very difficult to lease land from the private sector because existing laws do not cover the contract of land for farming or other purposes. Inadequate land laws are a major hurdle in encouraging large scale investment into the five priority industries. It not only makes initial investment difficult due to problems with acquisition but also creates insecure property rights. Although FDI ventures can acquire land for their specific purpose, land acquisition is filled with conditionality that differs from project to project. Similarly, a pre-requisite for land acquisition as an individual is Nepali citizenship and therefore, it is not possible for foreigners to acquire any land.

3.2.3 Liquidation and Barriers to Exit

The Doing Business Report of 2013 (World Bank, 2013) which measures 'Resolving Insolvency' reports Nepal at 121st position out of 185 economies. Nepal has slipped from its 119th position of 2012 in the same survey. An investor may choose to liquidate possessions or investments in order to fulfill his obligations towards creditors or simply to convert assets into cash and utilize or re-allocate them. The Company Act, 2006, has made provisions for the liquidation of a company in Nepal. Under voluntary liquidation, except in the case where a company has become insolvent in accordance with the prevailing law on insolvency, the shareholders of the company may liquidate the company either by adopting a special resolution in the general meeting or memorandum of association, articles of association or consensus agreement.

However, in the case of Nepal, the liquidation process is long and bureaucratic. There are various contradictory points in the Company Act and Insolvency Act (Nepal Economic Forum, 2012). For example, it is not clear whether the role of the court is just to appoint an enquiry officer and a liquidator or to also manage the whole liquidation process. According to the report of a talk-program on 'Insolvency in Nepali context' organized by Nepal Economic Forum on 3rd May, 2012, a history of companies that have gone into liquidation shows that there have been substantial impacts of political influence and poor supervision, leading to liquidation. Later on, during debt recovery, there appear to be contradictory findings in debt amounts and debtors' records. Upon reviewing both The Insolvency and The Company Act, neither the Insolvency Act nor the Company Act has made any clear provision on dealing with such cases. These cases lead to difficulties for the liquidator in terms of reconciling such amounts. Such a lack of implementation mechanisms leads to a liquidator not being able to finalize the process. Also, the liquidation process starts only after the inquiry officer and the liquidator submit their respective reports and when the court thinks that liquidation is the right move to make. However, the Insolvency Act 2006 has made a provision that gives the court the power to cease the liquidation process at any time, even though the process starts only after the court gives the necessary permissions in the first place. From a foreign investor point of view, this can pose a threat of an investment never being liquidated. Also, such provisions raise questions about the consistency of the court. Thus, there is a need to amend all such unclear and contradictory sections and ensure smooth implementation of the liquidation process. Companies should be free to go into liquidation. However, once the insolvency process gets underway, the company is blacklisted. This acts as a de-motivating agent to investors (Nepal Economic Forum, 2012).

Due to such contradictions in the regulatory provisions, prospective investors are discouraged from making an investment in the first place. This is a very ominous situation to any country that is looking to attract FDI for economic prosperity. Thus, a second generation reform in the liquidation aspect would be to make it as short and unbureaucratic a process as possible.

3.2.4 Repatriation

Laws regarding repatriation were identified as being encouraging to FDIs in all sectors. The Foreign Investment and Technology Transfer Act, 1992, was amended in 1996 so that it guarantees full repatriation of the amount received from the sale of equity, profits or dividend, and interest on foreign loan. Foreign currency earners are permitted to retain cent percent of their foreign currency earnings and are free to maintain foreign currency deposits with local banks. However, the implementation of this provision involves the central bank and several other government agencies. The process itself is cumbersome and many investors complain of not being able to repatriate profits. If foreign investment is brought in through mechanisms such as hundhi or other means, it is difficult to repatriate as there are no documents that show inflows of capital.

3.2.5 Infrastructure

Poor infrastructure significantly hampers the business environment. Power and transportation infrastructure are two such poor infrastructures that hamper the business environment. Most major cities face long hours of power outages, particularly during winter seasons, which lead to either increased costs of production or an outright loss of production. Poor road infrastructure makes access to many locations difficult and also increases transportation costs and inefficiency. In addition, the syndicate system in cargo transportation poses yet another challenge by increasing cost.

The Global Competitive index has ranked the infrastructure facilities in Nepal 1.8 out of 7 (7 being the highest and the 1 being the lowest). That is, Nepal ranked 143rd out of 144 countries in terms of infrastructure. It fared much better in all other factors considered in the index. Nepal's overall rank was 121 out of 144 countries (World Economic Forum, 2013). This example highlights the poor situation of current infrastructure in Nepal and how it hampers global competitiveness. In other word, poor infrastructure considerably affects the overall business environment which is yet another deterrent to FDI.

3.2.6 Political Instability

The uncertainty that has accompanied Nepal's prolonged political transition has discouraged both domestic and international investment (Ghimire and Poudel, 2012, as cited in SAWTEE, 2013). As the 'World Investment prospects survey 2007-2009' reports, high political risk is one of the key challenges that Nepal faces in attracting FDIs (UNCTAD, 2009). Political risks assessment has been found to be a critical factor to firms when deciding to invest in foreign countries. Political instability is also coupled with policy instability in Nepal which faces policy changes with the change of executives multiple times a year. This practice clearly does not offer the necessary policy stability required for FDI. Nepal's poor performance in this assessment has adversely affected foreign investment inflows into all sectors. Without improvement in the political environment, it is difficult to see how Nepal could significantly improve its FDI inflows into any of these sectors. However, innovative tools, like the use of international rating agencies, have been used by some countries with poor political environments to increase FDI flows.

3.3 Capital Account Convertibility

Capital account convertibility is another issue that has been identified as cross sectoral hurdle to the inflow of FDI. The Foreign Direct Investment and Technology Transfer Act, 1992 allows 100% investment in all sectors except those industries that are on the negative list. Foreign Exchange (Regulation) Act, 2019 (1962) has capital control in place, thus Nepal's capital account is not convertible. The act however prohibits outward flow of investment from Nepal. These are strong arguments which show that capital account convertibility is beneficial for FDI inflow, among other things (for example see: Gilbert, Irwin and Vines, 2000). If there is easy outflow of capital with the introduction of capital account convertibility, it helps increase the confidence of foreign investors. In addition to this, Nepalese investors can also invest in foreign countries that can help in bringing foreign investment in the long run as foreign investors believe in their partners more than anybody else. Removing capital controls would also go a long way in showing Nepal's commitment to open trade and investment. However, it is unlikely that a poor country like Nepal will be able to see an increase in FDI flow from capital account liberalization alone. The cost of liberalizing capital accounts might outweigh the benefits if the country's domestic markets remain protected and institutions remain weak (Gilber, Irwin and Vines, 2000). Removal of capital controls without addressing said issues might lead to excessive outflow of capital which would create a Balance of Payment (BoP) deficit and exchange rate problems. And this in turn would lead to economic instability. While capital account convertibility is a second generation reform required for FDI, it needs to be addressed through a separate act and legal provision instead of being combined it in the FDI act. This is because FDI is only one of the sectors that will be affected with capital account convertibility. However, as mentioned above, there are many domestic considerations with regards to capital account convertibility.

Capital account convertibility can be a gradual process and there are lessons to learn from emerging markets. India, for instance, has adopted a cautious approach with its first generation of liberalization addressing non-debt creating flows such as FDI and portfolio investments (Gupta & Gupta, 2013). It is believed that free global financial flows are beneficial for developing countries as they help improve global financial resources. The chances of flow of investment in developing countries are higher because the rate of return on capital is higher in developing countries (Gupta & Sathye, 2004).

3.4 FDI and Technology Transfer

Technology transfer is a critical advantage brought about by FDIs. Any attempts to increase FDI flows should also entail provisions on how technology transfers can best occur from FDIs. In the past, most of the technology transferred to Nepalese industries was via turnkey projects to the state sector that were financed through international loans and aids. In recent years, though, some large and medium scale industries have been established with foreign collaboration in the private sector (Nepal et.al, 2012). Foreign Direct Investment has played a major role in this, in the form of joint ventures, technical collaboration, import of machinery and equipment, technical assistance through human resources, etc. Informal modes like books, journals, promotional literature, and personal contacts have also been vital. More of such informal mode of transfer is prevalent in small and cottage Nepalese industries (Nepal et.al, 2012).

In a study conducted by Chiranjibi Nepal, Bishwa Raj Karki, and Kabya Prasad Niraula, they have focused on problems and issues of technology transfer in Nepalese small and medium enterprises (SMEs). Given that 40-60% of the total output or value added to the national economy of LDCs is by small and medium enterprises, a major concern on how Nepal could encourage and realize substantial technology transfer in these sectors. Some major hindrances present in the current technology transfer regime are the lack of technology assessment mechanisms, technological infrastructure, technical manpower, spare parts, and various financial issues (Nepal et.al, 2012).

3.5 Nepal's Commitment to WTO

Nepal became a full member of the World Trade Organisation (WTO) on 23 April 2004 (WTO 2013a). As a signatory to the WTO Agreements, Nepal is obligated by international law to comply with WTO's rules and regulations. There are two particular agreements relevant to Foreign Direct Investment in WTO. First is the Agreement on Trade-Related Investment Measures (TRIMs) which is a part of the Multilateral Agreement on Trade in Goods. The second is the General Agreement on Trade and Services (GATS), which addresses foreign investment in services (WTO 2013b).

TRIMs agreement is geared toward alleviating investment measures that restrict and distort trade in goods. Contracting parties must not apply investment measures that are inconsistent with Article III of GATT on national treatment and Article XI of GATT on prohibition of quantitative restriction. In other words, contracting parties should privilege foreign investors and local investors equally and remove all quantitative restriction on trade (i.e. restrictions other than duties, taxes and other charges). GATS contains clauses on restrictions to market access (elimination of qualitative restrictions), national treatment, and objective and transparent criteria for regulatory practices such as qualification requirement, licensing requirement, and so on.

Nepal, as a Least-developed Country (LDC), is eligible for Special and Differential Treatment (SDT) provisions which give LDCs special provisions to develop their domestic industries so as to ensure their effective participation in international trading systems. FDI relevant articles for these special provisions are Article IV:1 ; Article IV:2; GATS Annex of Telecommunication; Article 65.1; Article 66.1; Article 66.2 ; Article 67; Article 5.1; Article 5.2; Article 5.3. These measures encourage LDCs in trade through favourable terms of engagement, technical support, and flexible rules. Nepal did not have any trade related investment measures during its accession and has not been notified of any measures inconsistent with TRIMs since then (United Nations Department of Economic and

Social Affairs and the Committee for Development Policy Secretariat 2012). In addition the accession committee had superseded the Special and Differential Treatment provision of the TRIMs Agreement. The SDT provision in GATS calls for special priority for LDCS when negotiating specific commitments aimed at improving domestic service capacity, efficiency, and competitiveness which should be done, inter alia through access to technology, improvement in access to distribution channels and information networks, and liberalisation of market access in sectors of interest to LDCs. Further commitment has been made to provide technical assistance, capacity building programs, and efforts to build institutional and human capacity. Special provision is given to telecommunication services where foreign suppliers are encouraged to assist in transfer of technology, training, and other activities related to developing LDCs' telecommunication services (United Nations Department of Economic and Social Affairs and the Committee for Development Policy Secretariat 2012). The articles highlighted above give Nepal lots of wiggle room in its commitments to the WTO and special provisions to develop its capacity to attract foreign investment.

3.6 The Negative List

Foreign investments into some industries are almost always prohibited under concerns of national security. In Nepal, the investment regime permits foreigners to invest fully in most industries except those on the negative list. Reasons cited for prohibiting foreign investment in these industries are to promote domestic SME activity and national security. The protection argument has been debunked by empirical evidences in economics. Promoting domestic firms by protecting them from foreign competition could have, as it often does, counterproductive outcomes by making domestic firms dependent on state subsidies for survival (see Baldwin, 1982; Feenstra, 1992).

A country would like to put forward a basic negative list especially including industries such as minting of coins, arms and ammunitions and products that produce radioactive reaction. Industries such as these have strong reasons to fall in the negative list. These industries either pose huge public health hazards or directly influence the sovereign functioning of any country. However, Nepal's experience with the Foreign Investment Act of 1986 has already proved that having a long list of industries on the negative list or having a lot of conditionality in investment does not attract FDI[3]. It should be duly noted that these conditions not only protect domestic industries but will also be plagued by problems of inefficiency and ineffectiveness.

An FDI policy with several conditions and requirements only discourages foreign investors. If the FDI policy mandatorily requires local partners or does not allow full ownership then this is a signal to foreign investors that the country is not really interested in FDI. Therefore, although there may be pressure from domestic industries to limit competition and have a lot of conditions on FDI (with the argument of protecting and promoting domestic industries and production), the negative list should be a simple and limited one (similar to FITTA,1992) (The Himalayan Times, 2013).

3 For this, refer to FDI inflows before and after the introduction of FITTA, 1992. Data available at Department of Industries.

4. Attracting FDI – The Way Forward

Nepal needs to have a clear vision in terms of an FDI policy. As an LDC, Nepal does not have the required savings that can be directed towards investment. Nepal's projected gross domestic saving (GDS) as a percentage of Nominal GDP at producer's price is at 10 percent (NRB, 2012). This indicates that Nepal needs foreign capital to take advantage of existing resources and promote growth in the economy. While foreign aid is one option, foreign investment brings better outcomes. Therefore, second generation reforms in inviting foreign investment have become urgent in Nepal. Based on the analysis presented in this paper, the following are some measures of reform that can take us in the right direction:

4.1 Bilateral Agreements

1. Bilateral Investment Treaties (BITs) should be signed with those countries where there are higher chances of inflow of large investments. It also gives a positive message to other foreign investors, showing that the host country is seriously committed to safeguarding established foreign investment.

2. Power Trade Agreements (PTAs) with India should be conducted as soon as possible and the 2% Custom Tax with India should be removed because it makes the electricity produced in Nepal expensive. These agreements create the necessary environment for construction of large hydropower projects such as Tamakoshi III, Upper Karnali, Arun III, etc.

4.2 Business Environment

4.2.1 Increased Cost of Transaction

1. The approval process of FDI should be made simple and automatic so that there will be less human contact. It helps reduce corruption and other bureaucratic hassles. Vietnam has delegated this authority to local bodies which has empowered them and also helped simplify the process. This could be an important lesson for Nepal. The approval process should be delegated and simplified. This would free up higher level bureaucrats' time to engage in more important policy discourse and monitoring activities.

2. The requirements should be simple enough to comply with such that the monitoring process is more effective. While the DoI has been able to track the level of FDI that has been approved, it is still difficult to ascertain actual FDI in Nepal. With simple requirements, DoI would also be able to ensure compliance standards.

4.2.2 Land Acquisition

1. The Land Act of 1964 should be amended so that domestic and foreign investors can use state land for productive and commercial purposes.

2. The Agriculture Enterprise Act should be enacted to enable contract farming and leasing of state owned land for productive use to both domestic and foreign investors. In the absence of this Act, there are several regulatory challenges in large scale farming as well as commercialization and mechanization of agriculture in Nepal.

4.2.3 Infrastructure

1. The poor road infrastructure increases transportation costs and reduces efficiency. There needs to be additional investment especially in transportation infrastructure.

2. GoN also needs to enhance the rule of law condition and resolve the issues of syndicates. While this comes with a bundle of political economy factors, GoN can start breaking transportation cartels in select areas as pilot projects and experiment with several policy tools to achieve this. One such tool is to provide security to new transport entrepreneurs that want to ply on routes that are controlled by syndicates.

4.2.4 Liquidation

1. Ease up the process and remove inconsistencies related to liquidation. There is also a need to clarify the role of courts in liquidation and remove the dual interpretation of liquidators that is in practice today.

4.3 Nepal's Commitment to WTO with Regard to FDI

1. Nepal should utilize its Special and Differential Treatment (SDT) provision in the WTO to maximise the benefits it can reap from FDI inflow and technology transfer. The SDT provision can prove to be a very useful tool in developing the capacities of domestic industries while committing to liberal foreign investment regime.

4.4 The Issue of Caps and Floors

1. The introduction of minimum cap of US$ 50,000 in foreign investment is against the spirit of Foreign Investment and Technology Transfer Act 1992. Therefore, it should not be applied to any sector of the economy, especially Information Technology, in the name of protecting domestic industries as it discourages foreign investors from investing further in Nepal. It should be repealed by a court as it was brought forward by an administrative process. In

addition to this, it causes negative impact on idea based industries as the investment in small clusters is more beneficial. With floors and ceilings, FDI processing becomes cumbersome. Similarly, since Nepal is in a position where it requires foreign capital for growth, given the sad state of its business environment, it has not wielded enough bargaining power to attract FDI.

4.5 A Wider Vision and an Overhaul in the Regulatory and Legal Framework

The tide has changed in FDI since the 1990s. As emerging markets promise higher returns, the traditional tide of FDI flows from developing economies to developed economies has reversed to a certain extent. People are investing more in emerging markets like India, China, Vietnam, Laos and Cambodia to name a few in Asia (UNCTAD, 2006). If Nepal is serious about attracting FDI to aid its economic growth process then the competition it faces is intense in Asia. Albeit, the process of reform is easier as there are many lessons to be learnt closer to home and more suitable to the Nepali context.

Nepal needs a second generation of reforms in FDI. This requires a strategic vision for FDI promotion and an overhaul in the legal and regulatory framework. While the first generation of reforms targeted entry regulations, there are many inconsistencies in the Nepali policy environment. Although tax breaks are offered via the FITTA, the same is not provided through the Income Tax Act. Similarly, the approval process cannot be cleared by one government agency and requires the active engagement of several agencies under the current regime. Therefore, the reform process should now focus on removing these inconsistencies, simplifying the implementation mechanisms; delegating FDI approval processes and helping bring FDI processes under one government agency.

The second generation of reforms also includes sectoral reforms to make the best use of FDI. In the hydropower sector, the Electricity

Act of 1992 was mainly introduced to develop small scale hydropower projects. Therefore, it has not been able to address issues related to mega projects such as the problem of resettlement, construction of transmission lines, and multiple use benefits of hydropower. In addition to this, it has not envisioned a system of competitive bidding with zeroing system to make business deals transparent as major grievances surface due to non-transparent deals. Similarly in education sector, there is no legal provision in The University Grants Provision Act 1993, for the establishment of private universities in Nepal. The University Grant Provision Act 1993 was made for the development of universities in Nepal but has a narrow scope of public universities only. As a result, many affiliated colleges which have the capacity to develop as independent universities cannot do so. These are areas that have huge FDI potential and can contribute to the national economy by not just building capable human resources but also attracting foreign students.

Similarly, the Industrial Enterprise Act 1992 has not recognized Information Technology (IT) as an industry. As a result, IT industries cannot benefit from the various facilities that other manufacturing and service industries enjoy. This is yet another obstacle in terms of attracting FDI in IT. Global trends demonstrate that this is a low hanging fruit that we should take immediate advantage of.

Since Nepal does not offer a competitive edge in business environment, has a small market and is inherently at a disadvantage due to its landlocked geography, it needs to go the extra mile in offering a competitive edge in the regulatory framework and access to two neighboring emerging markets with a growing middle class demography. This, in essence, should be the guiding framework for the second generation of reforms.

References

Adhikari, R. (2013). 'Foreign Direct Investment in Nepal: Current status, prospect and challenges', South Asian Watch on Trade, Economics and Environment, Working Paper No. 01/13, pp. 1-29.

Baldwin, R. E. (1982). The political economy of protectionism. In Import competition and response (pp. 263-292). University of Chicago Press.

Chaunlagain, Y. (August 28, 2012). Official Development Assistance in Nepal: A Development Perspective. E-International Assistance. Retrieved on June 28, 2013 from http://www.e-ir.info/2012/08/28/official-development-assistance-in-nepal-a-development-perspective/

Chen, S. (2011, April 18). BBC News - Chinese overseas students 'hit record high'. Retrieved May 30, 2013, from http://www.bbc.co.uk/news/world-asia-pacific-13114577

Deuba, S.B. (2013, June 12). Vision for Tomorrow. Kathmandu: Republica Daily.

Dhungel, K.R. & Rijal, P. (2012). Investment Prospects & Challenges for Hydropower Development in Nepal. (p. 28). Kathmandu: Samriddhi, The Prosperity Foundation.

Federation of Nepalese Chambers of Commerce & Industry (FNCCI) & Samriddhi, The Prosperity Foundation. (2012). Nepal Economic Growth Agenda (NEGA) 2012. Kathmandu: FNCCI & Samriddhi Foundation.

Doing Business (2013). Ease of Doing Business in Nepal. Retrieved June 27, 2013, from http://www.doingbusiness.org/data/exploreeconomies/nepal/

Feenstra, R. C. (1992). How costly is protectionism?. The Journal of Economic Perspectives, 6(3), 159-178.

Gautam, P. (2012, April 22). Empty promises: POLITICS OF FOREIGN AID. Retrieved June 28, 2013, from http://www.myrepublica.com/portal/index.php?action=news_details&news_id=34163

Ghimire, P. (2012, September 20). Government opens to lease and contract farming. Republica Daily [Kathmandu].

Gilbert, C. L., Irwin, G., Vines, D. (2000). International Financial Architecture, Captial Control Convertability and Poor Developing Countries. Oversea Development Institute, viewed on 26th June 2013 from http://www.odi.org.uk/sites/odi.org.uk/files/odi-assets/events-documents/3430.pdf

Gupta, A. S., & Gupta, R. S. (2013, May 15). The challenges of opening up India's capital account. Retrieved July 19, 2013, from http://http://www.ideasforindia.in

Gupta, D., & Sathye, M. (2004). Financial Developments in India: Should India introduce capital account convertibility?. Retrieved from http://crawford.anu.edu.au/acde/asarc/pdf/papers/2004/WP2004_07.pdf

Gwartney, Lawson, J., & Hall, R. (2011). Economic Freedom of the World : 2011 Annual Report. Retrieved from Fraser Institute website: http://www.freetheworld.com/

Institute of Policy Studies of Sri-Lanka (2000). Foreign Direct Investment and Economic Integration in the SAARC region. Retrieved from SANEI website: http://https://www.google.com.np/search?q=Institute+of+Policy+Studies+of+Sri-Lanka+(2000).+Foreign+Direct+Investment+and+Economic+Integration+in+the+SAARC+region.+SANEI.&oq=Institute+of+Policy+Studies+of+Sri-Lanka+(2000).+Foreign+Direct+Investment+and+Economic+Integration+in+the+SAARC+region.+SANEI.&aqs=chrome.0.69i57.2292j0&sourceid=chrome&ie=UTF-8

Kirkpatrick, C., Parker, D., & Zhang, Y. (2006, April). reign Direct Investment in Infrastructure in Developing Countries: Does Regulation Make a Difference?. Transnational Corporations, 15(1). Viewed on 26th June from https://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/Documents/investing-in-vietnam.pdf

Legal Guide to Investment in Vietnam. (2012). Retrieved from http://http://www.vietnamlaws.com/pdf/LegalGuidetoInvestmentinVietNam.pdf

Manju, V. (2012, March 6). Indians, Chinese big spending tourists. Times of India [New Delhi].

Ministry of Agriculture and Cooperatives (MoAC) (2012). Agricultural Development Strategy-Assessment Report. Retrieved from https://www.google.com.np/search?q=Ministry+of+Agriculture+and+Cooperatives+(MoAC)+(2012).+Agricultural+Development+Strategy-Assessment+Report.&oq=Ministry+of+Agriculture+and+Cooperatives+(MoAC)+(2012).+Agricultural+Development+Strategy-Assessment+Report.&aqs=chrome.0.69i57.1103j0&sourceid=chrome&ie=UTF-8

Nepal, C., Karki, B. R., Niraula, K. P. (2003, November 12). Technology Transfer in SMEs: Problems and Issues in the Context of Nepal. Paper presented at the National Seminar on Building Capacity for Technology Transfer for Small and Medium Enterprises in Least Developed Countries: A Case in Nepal's Development Kathmandu, 12-13 November 2003. Retrieved from http://www.unescap.org/tid/publication/indpub2306.pdf

Nepal Economic Forum (2012). Proceedings Report. Insolvency in Nepali Context. Retrieved from Nepal Economic Forum website: http://www.nepaleconomicforum.org/uploads/news-updates/report/PR-Insolvency%20In%20Nepali%20Context_20121002040827.pdf

Neumayer, E., & Spess, L. (2005). Do Bilateral Investment Treaties Increase Foreign Direct Investment to Developing Countries?. UK: London School of Economics and Political Science.

Poudyal, P. M. (2013). Investment Opportunities in Nepal. Retrieved May 28, 2013, from http://www2.liu.edu/cwis/cwp/library/workshop/citapa.htm

Project Atlas (n.d.). India's Students Overseas. Retrieved May 30, 2013, from http://www.iie.org/en/Services/Project-Atlas/India/Indias-Students-Overseas

Ramkishen, R. (2004, January 3). Measures to Attract Foreign Direct Investment: Investment Promotion, Incentives. Economic and Political Weekly, (39), 12-16. Retrieved on June27, 2013 from http://articles.timesofindia.indiatimes.com/2012-03-06/india/31126478_1_indian-tourist-german-tourist-british-tourists

Rijal, P. (2013, May 30). Attracting Foreign Direct Investment in Nepal [Web log post]. Retrieved from http://econitynepal.com/?p=12

Sapkota, C. (2011, August 1). FDI inflows to Nepal, 1990-2010 [Web log post]. Retrieved from http://sapkotac.blogspot.com/2011/08/fdi-inflows-to-nepal-1990-2010.html

Sendaratne, N. (2011, May 29). The importance of Foreign Direct Investment: Imperatives for Economic Development. The Sunday Times. Retrieved on June 28, 2013 from http://www.sundaytimes.lk/110529/Columns/eco.html

The Himalayan Times (2011, May 25). Students going abroad take away Rs 27 b from Nepal. The Himalayan Times [Kathmandu]. Retrieved on May 30, 2013 from http://www.thehimalayantimes.com/fullNews.php?headline=Students+going+abroad+take+aay+Rs+27+b+frowm+Nepal+&NewsID=289277

The Himalayan Times (2013, June 21). Draft of Foreign Investment Act Backtrack. Himalayan News Service.

The Heritage Foundation (2013). 2013 Index of Economic Freedom. Retrieved June 25, 2013, from http://www.heritage.org/index/country/malaysia

Transparency International (2012). Corruption Preception Index 2012. Retrieved June 27, 2013, from http://cpi.transparency.org/cpi2012/results/

Tretter, & Blake (2013). The Effect of Myanmar's Foreign Investment Policies on FDI Inflows: An Analysis of Panel Data across ASEAN Member Countries.

UNCTAD (2012). Global Investment Trend, World Investment Report 2012. Retrieved 24 June, 2013 from http://www.unctad-docs.org/files/UNCTAD-WIR2012-Chapter-I-en.pdf

UNCTAD. http://unctad.org/en/Docs/iteipcmisc3_en.pdf

UNCTAD (2007). World Investment Prospects Survey 2007-2009. United Nations: New York and Geneva.

UNCTAD (2006). World Investment Report 2006. FDI from developing and transition economies: Implications for Development. United Nations: New York and Geneva.

United Nations Department of Economic and Social Affairs and the Committee for Development Policy Secretariat. (2012). 'Nepal', Survey on International Support Measure specific to the Least Developed Countries (LDCs) related to WTO Provisions and Preferential Market Access, United Nations Department of Economic and Social Affairs. Retrieved June 26, 2013, from esango.un.org/ldcportal/documents/10179/.../summary_results_nepal.pdf

Wagle,B. , Shrestha, P., Thapa, P. J., (2012). Review of Agriculture Sector & Policy Measures for Economic Development in Nepal. Kathmandu: Samriddhi, The Prosperity Foundation.

WTO (2012). Trade Policy Review: Nepal. Retrieved June 25, 2013, from https://www.wto.org/english/tratop_e/tpr_e/g257_e.doc

WTO (2013a). Nepal and the WTO. Retrieved June 23, 2013, from http://www.wto.org/english/thewto_e/countries_e/nepal_e.htm

WTO (2013b). Trade and Investment. Retrieved June 23, 2013, from http://www.wto.org/english/tratop_e/invest_e/invest_e.htm

Annexes

Annex 1: FDI Related Policy Regime in Competitive Countries of Nepal

Policy Area: Foreign Equity Participation	
Bangladesh	100% ownership
India	• Upto 51 % in most industries • Upto 24 % in industries reserved for the small scale sector • 100 % in export oriented industries like power, electronic and software technology
Nepal	100% percent foreign ownership in almost all sectors
Vietnam	• 100% ownership in almost all sectors • Except public limited companies where only 49% is allowed
Sri Lanka	100% foreign ownership in almost all sectors

Policy Area: Fiscal Incentives	
Bangladesh	• Tax holidays for industries located in free trade zones (3-7 years depending on their location) • Reduced Import duties on capital machinery and spare parts • Tax exemption on royalties, interest on foreign loans, capital gains from the transfer of shares • Duty free imports for all exporters
India	• 100 % export oriented units exempted from payment of corporate income tax for the first five years of operation • Finance for export from banks at special concessional rates of interest • Tax relief under avoidance of double taxation agreements • Income Tax holiday for 100% export oriented units and units in export processing zones for ten years

Policy Area: Fiscal Incentives	
Nepal	Income tax exemption on interest income earned from foreign loan; national priority industries and for 5 years from the date of commercial production in manufacturing energy based , agro and forest-based and mining industries.
Vietnam	• Multiple VAT system - 0% for exported goods - 5% for essential goods - 10% for activities not specified as not subject to VAT - Flat income tax rate of 20% for non-residents Vietnamese • For others income tax rate is 5, 10,15,20,25,30,35 percentages
Sri Lanka	• Tax holidays (5-20 years) depending on the value of investment, employment, and foreign exchange potential • Duty free imports of capital goods and raw materials for export production • Exempted from the provisions in the Import and Export Control Act

Policy Area: Repatriation	
Bangladesh	Repatriation of capital and dividends allowed
India	• Repatriation of foreign capital invested, profits and dividend earned after payment of taxes • Units operating in a limited list of consumer goods industries are subjected to dividend balancing with matching export earnings for a period of seven years
Nepal	Repatriation of dividends and capital with certain restriction
Vietnam	• Profit can be repatriated • No Tax on dividends
Sri Lanka	Repatriation of profits and dividends allowed

Policy Area: Infrastructural Incentives	
Bangladesh	• Export Processing Zones • Relatively lower price of land in industrial estates/areas with electricity, gas, water, sewerage etc

Policy Area: Infrastructural Incentives	
India	• Export Processing Zones • Foreign company can acquire or hold immovable property in India for carrying on its activity. • Foreign citizen of Indian origin may also acquire any immovable property in India, except for agricultural land, farm house and plantation.
Nepal	• Export Processing Zones • 11 Industrial Districts provide developed land on rent and other utility facilities at reasonable rates • No individual foreign national can own land and building • Purchase of land and building in company's name permitted
Vietnam	• Export Processing Zones • A foreign investor may lease the land directly from the Government for certain period
Sri Lanka	Export Processing Zones

Source: FDI and Economic Integration in SAARC, IPS, Sri Lanka, SANEI: 2000, An Investment Guide to Vietnam and Legal Guide to Investment in Vietnam

Annex 2: Specific Challenges in Major Growth Sectors

S.N.	Economic Sectors	Major Challenges
1.	Hydro-power	Lack of power trade agreement (PTA) with India. Lack of provision of sovereign guarantee. Lack of project development agreement (PDA)
2.	Agriculture	Lack of energy for mechanization. Delay in promulgating Agriculture Enterprise Act
3.	Tourism	Lack of regional airports. Poor infrastructure. Tax rate on complementary industries. Poor technology
4.	Information Technology	Lack of technology and skill set. Cap on investable capital.
5.	Education	Lack of technology and skill set.

Annex 3: List of people consulted for 'FDI: Towards Second Generation of Reform'

Name	Association
Mr. Nar Bahadur Thapa	Director, Nepal Rastra Bank
Mr. Tika Rai	Magnus Consulting Group
Mr. Sashi Sagar Rajbhandari	Former Director, Nepal Electricity Authority
Mr. Umesh Raj Poudel	Charter Accountant
Ms. Anna Maria	Fire and Ice Restaurant
Mr. Bimal Prasad Wagle	Chairman, PEDB
Mr. Ashay Thakur	Director, Deerwalk
Mr. Guru Neupane	Coordinator, Energy Cell, CNI
Mr. Krishna Acharya	Under Secretary, Investment Board Nepal
Mr. Sakar Pudasaini	Director, Learning Labs
Mr. Santosh Koirala	Senior Finance Officer
Ms. Shrijana Bhattrai	Promotional Specialist, Investment Board Nepal
Mr. Sujit Acharya	Chairperson, Energy Development Council
Mr. Krishna K.C.	Junior Officer, Nepal Rastra Bank
Dr. D.B. Shakya	NEAT Project
Mr. Narayan Acharya	Joint – Secretary, Ministry of Industry
Mr. Madhukar SJB Rana	Former Finance Minister
Mr. Santosh Koirala	Verisk
Mr. Ajay Pradhanang	NYEF
Mr. Anup K Shrestha	Deputy Director, FNCCI
Mr. Gopal Koirala	Under secretary, MOI
Mr. Sanjib Subba	CEO, NBTI
Mr. Prabhu Man Singh	NITI Foundation
Mr. Subash Thapa	BEED
Dr .Chiranjibi Nepal	Senior Economic Advisor, Ministry of Finance
Mr. Dipak Ghimire	Legal Officer, DoI
Mr. Anil Shah	CEO, Mega Bank

Dr. Hemanta Dawadi	Executive Director, FNCCI
Mr. Asgar Ali	F1 Soft
Mr. Subash Sharma	F1 Soft
Mr. Suraj Vaidhya	President, FNCCI
Mr. Bhaskar Raj Rajkarnikar	Senior Vice-President FNCCI
Mr. Pashupati Murarka	Vice-President, FNCCI
Mr. Tana Gautam	Former Secretary, GoN
Mr. Purushottam Ojha	Former Secretary, GoN
Dr. Subarna Das Shrestha	President, IPPAN

Samriddhi, The Prosperity Foundation an introduction

Samriddhi, The Prosperity Foundation is an independent policy institute based in Kathmandu, Nepal. It works with a vision of creating a free and prosperous Nepal.

Initiated in 2007, it formally started its operations in 2008. The specific areas on which the organization works are:

i. Entrepreneurship development
ii. Improving business environment
iii. Economic policy reform
iv. Promoting discourse on democratic values

Centered on these four core areas, Samriddhi works with a three-pronged approach—Research and Publication, Educational and Training, and Advocacy and Public Outreach.

Samriddhi conducts several educational programs on public policy and entrepreneurship. It is dedicated to researching Nepal's economic realities and publishing alternative ideas to resolve Nepal's economic problems. Samriddhi is also known for creating a discourse on contemporary political economic issues through discussions, interaction programs, and several advocacy and outreach activities. With successful programs like "Last Thursdays with an entrepreneur" and "Policy Talkies", it also holds regular interaction programs bringing together entrepreneurs, politicians, business people, bureaucrats, experts, journalists, and other groups and individuals making an impact in the policy discourse. It also hosts the secretariat of the 'Campaign for a Livable Nepal', popularly known as Gari Khana Deu.

One of Samriddhi's award winning programs is a five day residential workshop on economics and entrepreneurship named Arthalya, which intends to create a wave of entrepreneurship and greater participation among young people in the current policy regime.

Samriddhi is also committed towards developing a resource center on political economic issues in Nepal called Political Economic Resource Center (PERC) currently housed at Samriddhi office. It also undertakes localization of international publications to enrich the political economy discourse of Nepal. Samriddhi was the recipient of the Dorian & Antony Fisher Venture Grant Award in 2009, the Templeton Freedom Award in 2011 and the CIPE Global Leading Practice Award in 2012.

(For more information on the organization and its programs, please visit www.samriddhi.org)

More from Samriddhi...

01. Towards Enterprise Building in Nepal
02. Towards Enterprise Building in Nepal (Vol. II)
03. उद्यमशीलता विकास: हाते पुस्तिका
04. Economic Growth: a pocketbook series
    - i. आर्थिक स्वतन्त्रता
    - ii. उद्यमशीलता विकासमा बजारको भूमिका
    - iii. बजारका गुणहरु
    - iv. Role of Rule of Law in Enterprise Building
    - v. Role of Government in Enterprise Building (Vol. I)
    - vi. Role of Government in Enterprise Building (Vol. II)
05. Economic Growth and The Private Sector of Nepal
06. दासत्वको बाटो (Nepali Translation of "The Road to Serfdom")
07. Nepal Economic Growth Agenda (NEGA), Report 2012
08. Critical Constrains to Economic Growth of Nepal
09. Investment Prospects and Challenges for Hydropower Development in Nepal
10. Review & Overview of Economic Contribution of Education in Nepal
11. Private Sector Participation in Transport Infrastructure Development in Nepal
12. Review & Overview of Economic Contribution of Tourism Sector in Nepal
13. Review of Agriculture Sector & Policy Measures for Economic Development in Nepal
14. Contract Enforcement: The Practicalities of Dealing with Commercial Disputes in Nepal
15. Industrial Relations: An Institutional Analysis

All the publications are available in Samriddhi, The Prosperity Foundation and major bookstores in the country.

'Foreign Direct Investment: Towards Second Generation of Reforms' is one among six research paper series prepared for the Nepal Economic Growth Agenda (NEGA), 2013. NEGA is an annual constraints analysis performed by Samriddhi Foundation to identify, deliberate and offer policy alternatives to existing policy bottlenecks that hinder Nepal's economic growth.

After NEGA 2012 identified five growth sectors of the Nepalese economy viz. agriculture, education, tourism, hydropower and infrastructure, NEGA 2013 focuses on researching cross-cutting issues that affect growth in all these sectors and hinders Nepal's economic growth process. The cross – cutting issues covered by NEGA 2013 are industrial relations, contract enforcement, anti-competitive practices, foreign direct investment, public enterprises and regulatory environment for businesses.

The first generation of reforms in foreign direct investment took place in the form of Foreign Direct Investment and Technology Transfer Act of 1992. This act sought to ease up the process of FDI in Nepal focusing on entry and exit mechanisms. It also opened up several sectors previously barred from FDI while maintaining a small negative list. However, it has been more than twenty years since this reform and owing to the growth of FDI in emerging markets especially in Asia, it is time for Nepal to embark on the second generation of reforms. This paper is an attempt to identify challenges that Nepal faces in terms of attracting FDI and to develop a framework for the second generation of reforms.

Samriddhi, The Prosperity Foundation

P. O. Box: 8973, NPC 678
416, Bhimsengola Marga, Minbhawan Kharibot
Kathmandu, Nepal
Tel.: (+977)-1-446-4616/448-4016
Fax: (+977)-1-448-5391
E-mail: info@samriddhi.org

www.samriddhi.org