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Samriddhi, The Prosperity Foundation: an introduction
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Samriddhi, The Prosperity Foundation
November, 2014
## Abbreviations and Acronyms

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<thead>
<tr>
<th>Abbreviation</th>
<th>Full Form</th>
<th>Description</th>
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<tbody>
<tr>
<td>BITs</td>
<td>Bilateral Investment Treaties</td>
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<td>BIPPA</td>
<td>Bilateral Investment Promotion and Protection Agreement</td>
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<td>COMEX</td>
<td>Ministerio de Comercio (Exterior)</td>
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<td>CINDE</td>
<td>Costa Rican Investment Promotion Agency</td>
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<td>DoI</td>
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<td>DoL</td>
<td>Department of Labour</td>
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<td>DTAA</td>
<td>Double Taxation Avoidance Agreement</td>
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<tr>
<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>FIP</td>
<td>Foreign Investment Policy</td>
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<td>FITTA</td>
<td>Foreign Investment and Technology Transfer Act</td>
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<td>FIWOP</td>
<td>Foreign Investment and One Window Policy</td>
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<td>GATS</td>
<td>General Agreement on Trade and Services</td>
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<td>GATT</td>
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<td>GDP</td>
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<td>GoN</td>
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<td>IBN</td>
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<td>IIPB</td>
<td>Industry and Investment Promotion Board</td>
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<td>IPB</td>
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<td>ILO</td>
<td>International Labour Organization</td>
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<tr>
<td>IT</td>
<td>Information Technology</td>
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<tr>
<td>LDC</td>
<td>Least Developed Country</td>
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<td>MoH</td>
<td>Ministry of Home</td>
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<td>MoI</td>
<td>Ministry of Industry</td>
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<tr>
<td>MW</td>
<td>Mega Watt</td>
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<tr>
<td>NEGA</td>
<td>Nepal Economic Growth Agenda</td>
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<td>NRB</td>
<td>Nepal Rastra Bank</td>
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NRN  Non Residential Nepalis
PROCOMER  Costa Rica Trade and Promotion Agency
SMEs  Small and Medium Enterprises
USAID  United States Agency for International Development
UNCITRAL  United Nations Commission on International Trade Law

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

As global markets become increasingly accessible, the need to restructure policies such that they are able to reap the benefits of emerging markets becomes eminent. Firms from rich countries will look for avenues of investment and resource rich countries will benefit to welcome such ventures. These interactions may increase the profitability of incoming firms while the introduction of foreign capital will play vital role in enriching various factors of production of the host country. Fortunately, accumulation of capital does not only occur for extractive or exploitative purposes and businesses of all kinds can be cultivated in an environment that allows for easy entry and exit, complete control of assets and product pricing, and freedom in deciding the firm’s future. Nepal aspires to graduate into a Developing Nation category by the year 2022 and such goals demand that Nepal hasten its pace of industrialization and create a policy environment that allows for vibrant participation of private sector participation from both domestic and foreign entities.

Effective and targeted investments have never been Nepal’s forte and the decade-long civil war saw the rate of development activities slump even further. Economic theory suggests that a proper mix of labour and capital is essential to effectively carry out production but our low domestic saving rate, standing at 9%, suggests that Nepal, alone, may not possess the ability to build up enough capital to devise realistic strategies to achieve its development targets (Central Bureau of Statistics 2013). While the country holds immense potential as a hydropower developing country, as a religious, cultural, and adventurous tourism destination, as a breeding ground for Information Technology experts, or even as a regional hub for world-class education services, current trends do not provide evidence to guarantee efficient utilization of resources. The gross
capital formation stands at 21.2% of GDP, of which, over 81% comes from the private sector. Asian Development Bank’s (ADB) Macro-economic update Nepal (2014) forecasts that only 16.5% of the fiscal budget will be spent for capital formation, highlighting inadequate government attention to this crucial aspect (Ministry of Finance, 2013). However, owing to technological progress and relatively safe political environment, Nepal can easily offset its low domestic capital formation rate by allowing the participation of foreign entities in our markets as Foreign Investments (FI) play an important role in fostering economic growth (Kohler, 2010; Asiedu, 2002). However, investments are not possible without an encouraging environment (Kohler, 2010). So, it is of utmost importance that the GoN clearly communicate its intentions to welcome and encourage private investments from within and without its boarders by providing an unambiguous picture of the terms and conditions, incentives, privileges, guarantees, and restrictions (if any) thereof.

With the promulgation of Foreign Investment and Technology Act, 1981, Nepal opened up avenues for foreign investments in Nepal. Since the 1981 Act, which concentrated on developing infrastructure and spreading social welfare, through the liberalization period and policies of 1992 to the currently floated draft of Foreign Investment Policy, 2014, Nepal has continually made scores of amendments in its Foreign Investment Policies (FIPs) to align its economy with contemporary economic practices. Foreign Investment and Technology Transfer Act (FITTA), 1992 opened foreign investment in any quantity and any sum of investment except in a few limited sectors included in its negative list. It has been 22 years since the promulgation of FITTA 1992 and current global economic trends require that Nepal embark on a process of introducing a “second generation” of reforms to the existing policy. It is against this background that the Ministry of Industry (MoI), Government of Nepal (GoN) floated a draft of Foreign Investment Policy, 2014 (hereon “FIP draft”, or “draft”, or “new draft”).

World Bank’s ‘Doing Business Report 2014’ ranks Nepal 109th out of 189 economies under observation, thus, indicating stringent regulatory and bureaucratic hurdles while starting and conducting business. Similarly,
the Heritage Foundation places Nepal 149th out of 165 economies in its Economic Freedom of the World Report 2014 which highlights appalling levels of property rights, lack of ease in doing business, inept rule of law and other similar “economic” indicators (Economic Freedom of the World report, 2014). Likewise, Nepal ranks 157th in United Nations Development Programme’s (UNDP) 2013 Human Development Report with an index of mere 0.463 thereby reflecting Nepal’s low “average achievement in key dimensions of human development: a long and healthy life, being knowledgeable, and ... standard of living (Human Development Report, 2014)” . These are rather ominous statistics for a country that aims to graduate to a Developing Nation category in the next 8 years. These are clear signs that steer interested entrepreneurs into contemplating if Nepal really is a proper destination for investments. Such numbers indicate a low degree of economic freedom and ease of doing business. One may even infer that if foreign investments were made in Nepal, the absorption capacity of Nepal’s human capital may not possess the ability to adapt to the high levels of foreign investments and technology transfers.

Samriddhi, The Prosperity Foundation (hereon “Samriddhi”) has therefore attempted to evaluate the proposed Foreign Investment Policy to assess whether or not this policy sets the right tone for Nepal to lure foreign investments that are required for the overall development of the Nepalese economy and, ultimately place Nepal among developing nations. Sessions of individual and group consultations with experts in the field of foreign investments, prominent bureaucrats, private entrepreneurs, active foreign investors and other stakeholders were conducted to bring some incongruities of the FIP draft to light and to discern firsthand on what a good policy would sound like. In the case of Nepal, policies are not legally binding and they simply provide a direction for decision makers at the executive level. Hence, only making changes in the policy document will not ensure its implementation. Any serious debate in the policy reform process needs to address the amendments that need to be made upon the prevailing act to ensure that the reform measures are implemented.

This evaluation was preceded by a comparative analysis of the proposed FIP of Nepal with counterpart policies in other Asian economies
which share similar history and nature in terms of economic status. These activities have helped Samriddhi better articulate the requirements of a liberal FI policy while incorporating the views of parties directly affected by such policies.

The section to follow describes foreign investments and takes a stance on what a sound Foreign Investment policy would look like. In Chapter 3 the different topics addressed by the newly floated FI policy document is introduced. It also includes the policy’s provisions to other factors of macroeconomic significance. Some reference is also made to countries such as Costa Rica, Mauritius, and Ghana to highlight the provisions and changes that contributed to FDI inflows in these countries. Chapter 4 then focuses on Nepal to provide recommendations that would harmonize its law with successful practices implemented in other parts of the world. The final chapter concludes the paper.
II. Competitive Edge on FDI

1. How can Foreign Investments Help?

If markets could simply be classified as primitive and advanced, Nepal would, no doubt, fall into the primitive market category. However, Nepal would greatly benefit from the presence of advanced industries. Briefly, domestic (comparatively primitive) enterprises would have the chance to learn about business practices that enabled the transformation of advanced industries and they would also be pressured to become more efficient at using resources and converting raw materials into finished goods. Once such voluntary or involuntary changes occur in the country, they persist, as sunk costs, and ultimately transform the face of the economy.

2. Macro and Microeconomic Reforms and Foreign Direct Investment

Out of the many factors that determine the incidence and effectiveness of FIs entering a country, the current macroeconomic condition of the country is definitely important. Elizabeth Asiedu, in her paper On the Determinants of Foreign Direct Investment to Developing Countries: Is Africa Different, introduces a few variables that have been widely discussed in literatures related to FDI. She mentions that while there is significant evidence highlighting the positive effects of determinants such as openness to trade and the quality of infrastructure, the negative influence of high taxes and political instability, the reaches of factors such as labour costs and per capita GDP are not definitive (Asiedu 2002). Foreign investments, and the capital that follows such investments, not only depend on the host country’s economic situation, it can also help influence the host’s economy.
in the future. New firms and institutions establish room for the creation of new goods and services and, in turn, create new avenues of employment for the host country residents. However, money flows—like water—and has the affinity to accumulate in areas where it is already in excess, and foreign investments do not arrive in the complete absence of the ability or willingness to receive such monies. Good economic policies and a sound economic structure can greatly contribute to channel accumulated wealth to areas where it is greatly needed.

Similarly, with increasing globalization, and in light of Nepal taking steps toward reducing trade barriers by partaking in various bilateral and multilateral trade agreements, the size of Nepal’s domestic market will become a less important feature for attracting FIs (Blomström et al 2003). Meaning that the “region” that the country is part of becomes a more important factor. Blomström and Kokko argue that firms make decisions on where to establish their enterprise based on the cost of production at the particular location rather than based on the size of the market at that location (Blomström et al 2003). From this reason, we can conclude that firms will choose a particular country location if employing a particular nation’s labour force and other available resources reduces its cost of production or at least provides some advantage to using similar resources in an alternative country. While one may conclude that cost of production disproportionately affects firms seeking an export base, the decision on whether to start a venture, regardless of a firm’s aims, depends on a variety of indicators such as wealth, infrastructure, skill level, and political stability (Blomström et al 2003). Despite the fact that a country can have an amazing record in terms of macroeconomic performance, such numbers will mean little if the foreign companies cannot tap the market to make use of such features. Herein, government bureaucracy and procedures related to entry and exit, by deciding how easily firms can establish and conduct business, will be an important topic of consideration for investors.

The establishment of bureaucracies and related procedures highlight a typical transfer problem proposed by Bhagwati, Brecher, and Srinivasan in their paper *DUP (Directly Unproductive Profit seeking) Activities and
Economic Theory. They establish that when a transferable wealth is moved through the government budget instead of directly being transported to the hands of a consumer, transfer seeking lobbying (or rent seeking activity) occurs (Bhagwati et al 1984). In our analysis of Foreign Investors and their investment decisions, if we assume investments to be our “transferable wealth” and the money required to screen and regulate such investments (wealth) due to the establishments of various bureaucracies and agencies to reflect its “movement through the government budget,” we can envision transfer seeking actions to occur from the hands of those who feel they have something to gain from allowing investors to commence activities in the nation. An individual working in any organization that has the ability to allow or disallow an investment can easily wield that power to achieve personal gains. In the same way, on the promotion side, individuals in charge of promoting investments can engage in rent seeking activities, thereby, dissuading potential investors.

The “transfer seeking lobbying” is, therefore, the unproductive profit seeking activity that could be seen while parties try to coerce government bodies to prevent the entry of new firms into the market, or through activities like lobbying for the promotion of one kind of business activity versus another. Likewise, rent seeking activities by bureaucrats, excessive hurdles while establishing and closing businesses and similar pursuits will have a damaging reputation on the host country provisions. A policy’s intent to introduce incentives can, also, chime in with the above mentioned counter-productive activities; a host of fiscal incentives may induce firms to not create any extra wealth but aim to obtain as much incentive as possible. Similarly, imposing regulatory or registration related steps on the pretence of providing incentives may be used by officials to engage in rent seeking activities. In an environment where policies are hard to navigate, such incentives may not help investors as the cost in establishing businesses may outweigh the benefits provided by the provision.

Along with the capacity and the decisions discharged by bureaucratic bodies, the availability of any country’s resources also plays a fateful role in the entry of foreign money. Human resources are an
important resource and the entry of FIs, while depending on the ability of any country’s labour force, may also add to the capacity and usefulness of its manpower. Education level, access to health and nutrition facilities, and wages may all dictate the ability of a particular nation’s populace. While a high level of education attainment and adequate health facilities may bolster a nation’s labour force’s worthiness, high wages may discourage efficiency seeking investments (Asiedu, 2002). However, the increase in job prospects and a higher demand for workers may increase the bargaining power of a country’s labourers and improve wage conditions in the long run (Friedman, 1977). Efficiency seeking investments are the ones not particularly looking to tap into any specific market and such projects are more likely to allow the availability of resources more weight when making investment decisions. For example, Costa Rica’s incredible performance in attracting FDI in the manufacturing sector, especially in IT and medical instrument manufacturing, is credited, in part, to its highly skilled and educated labour force (Cordero et al, 2008). The new FIP’s aim to prioritize investments in sectors such as hydroelectricity, infrastructure development, mining and manufacturing, tourism, and agriculture highlight Nepal’s sentiment of attracting efficiency seeking investment projects. Fostering a well educated, healthy, and productive labour force is, hence, one of the main steps towards attracting FIs.

Besides access to strong and productive resources, investments are also dependent on the control an investing party can assert on its earnings. High taxes on income can deter investments and excessive regulations can prevent investors from establishing enterprises in the first place. While all economies have some form of taxation and regulation in place, care should be taken to harmonize such policies so that there are no conflicting provisions and to ensure that entities paying them and those receiving such payments start out on a similar footing. Inadequately and improperly worded tax and customs documents can cause confusion and establish uncertainty among possible investors regarding the amount of money they have to pay out. Moreover, various terms and conditions imposed by such laws and acts increase transaction costs and directly add to the expense of doing business. Edmiston, Mudd, and Valev conclude that “a large
number of special tax rates for various economic activities, the ambiguous language in the laws, and frequent and inconsistent changes in tax laws have a deterring effect on FDI (Edmiston et al, 2003).” Nepal’s history of changing provisions with changes in leadership, inharmonious tax laws, and different kinds of treatment for investors based on investment amount and involvement sectors do little to set Nepal apart in terms of excellent tax provisions for investors.

One of the first steps that need to be taken in order to improve the investment climate of Nepal, therefore, is to insure that documents and policies that are instated are simple to navigate and easy to comprehend. Such revisions will greatly reduce the time and costs involved and, thereby, facilitate the establishment of new businesses.

As important the liberalization of government policies and procedures are, opening up the country financially is also an important step that needs to be undertaken by countries looking to increase the roles that markets have to play. In short, a desirable amount of competition requires that certain prerequisites are fulfilled so that domestic firms benefit from new entrants and domestic entities also have improved access to markets abroad. The Nepalese rupee was made completely convertible in the current account in 1993 (Pant, 2007). However, a properly liberal market requires both current and capital account convertibility. Current account convertibility allows the Nepalese rupee to be converted into any convertible currency and capital account convertibility, according to the Reserve Bank of India is “the freedom to convert local financial assets into foreign financial assets and vice versa at market determined rates of exchange (Reserve Bank of India, 1997).” In light of globalization and a rapid integration of world markets it is imperative that Nepal also make moves to having greater control over world market phenomenon by actively discharging control over its position in the world. The best way to meet this end is to allow markets to decide where Nepalese assets are most needed and allow entrance of foreign assets to Nepal when the need arises. However, Capital Account Convertibility (CAC) requires some prudent measures to be taken in order to prevent unwanted, panic infused,
capital flights. Moreover, a secure CAC regime requires that the export base is expanded to protect the implementing country from trade shocks (Schneider, 2000). Expanding the export base will ensure that the country’s trade balance is not disturbed by the cyclical pressure. Hence, a liberal and gradual conversion process is required to stimulate the entry of foreign monies and to create a stock of capital within the nation which may be easily available for use (Schneider, 2000). Moreover, CAC eases the access of foreign investors into the nation and simultaneously also provides more avenues for domestic investors to acquire funding from channels overseas (Schneider, 2000). In conclusion, it is high time to initiate widespread macroeconomic reforms as it will do more to promote investments than simple sector-wise changes.

3. How can Governments Help?

For firms to perform effectively, it is important to let the market determine the fate of its actions. Too much government intervention in market processes not only discourages investments, it also stunts the proper progress of firms. Firms, domestic and foreign, should be allowed to access the allowable sectors of the economy without barriers. While some restrictions may be reasonable—considering the importance of matters such as public security—a clearly defined list of acceptable and unacceptable investment sectors will greatly help investors come to a decision as overly inflexible approval processes may discourage potential investors. A concise list that clearly defines the industrial sectors that are closed to investors will definitely discourage foreign firms from wanting to cater to the particular market. Hence, such a list will enable the government to eliminate unnecessary screening processes and help to reduce the number of days it takes for a particular project to get approved.

Soto and Ghossein in their IFC publication *Starting a Foreign Investment Across Sectors* elaborate that while the growth rate and growth potential of a country are important factors in determining the amount of foreign capital entering a country, the institutional arrangements play a pivotal role in the ultimate decision that firms take regarding investments
abroad. They argue that policies that create hurdles in registration and “licensing” have more negative effects on foreign investments than investment thresholds and caps (Ghossein et al, 2013). Their 2013 report, published in November of the same year, showed that foreign investments, on average, took 55 days longer to be officially recognized than domestic firms. Investments of all kinds should be treated equally as they are valuable sources of capital and technological know-how (Ghossein et al, 2013).

Research has shown that strict regulatory regimes may foster corruption and rent seeking behaviour as investors will have incentives to try and wield more market power by manipulating regulatory agencies to exercise greater control over existing wealth rather than start a new venture—because of the associated cumbersome process—and create new wealth (Ghossein et al, 2013).

4. Foreign Investments require...

A. Human Resource

Human capital is just as important as physical capital and the establishment of industries may hinge on the availability of intellectual labour. In many less-developed and under developing nations, human capital may be in shortage. However, unlike physical capital—which may be imported to deal with the unavailability of the same in one geographical region, the stock of human capital in any region is accumulated over time (Glomm et al, 1992). Easy access to factors such as schooling, health and nutrition facilities, coupled with sound social structure cater to a good HDI score, implying higher degree of human development. The effects of factors such as education and improved health facilities, however, do not show immediately (Schultz, 1961); educated parents might (be able to) save more money for their children than their uneducated parents. Hence, improvements in human capital happen over a course of time and their effects come to light after the elapse of a certain period.

For foreign firms looking to invest, the availability of human capital is an important issue. However, the problem of human capital shortage in
one country can easily be tackled if labourers from other nations are allowed to obtain employment in the country facing shortage. But the labour laws of most countries prohibit, or in some form restrict, employment of foreigners.

Barring foreign employment may be an indirect way of barring foreign nationals' participation in an economy. However, there are also other, more direct, ways by which nations bar the entry of foreign investments. Some countries limit the amount of equity that a foreign national may hold and some others stipulate the minimum amount of investment required in case foreign parties want to invest.

Labour laws and labour relations within a country are also matters of significant concern to foreign investors. While it is natural for firms to expect some degree of human capital development in host nations through the availability of basic needs such as education and health facilities, the ideologies of the collective is also an important point for foreign investors. With an increasing need of employees in large scale industries, it is natural for unionization to occur. Unions give sound to the voice of labourers and help firms identify labourer needs. However, the politicization of labour unions in Nepal does not in any form help the image of the Nepalese labour market. The paper Industrial Relations-An Industrial Analysis published by Samriddhi shows that labour union strikes are prevalent during periods of political turmoil (Nepal, et al 2013). Such statistics lead one to conclude that unions in Nepal propagate and sway according political agendas rather than the welfare of its members.

B. Unfettered Use of Money

Repatriation of earnings—returning investments to its country of origin—is an important topic for investors. Branches of Multinational Corporations or other foreign firms will have been established with money that has been imported from other areas. So, it is natural that after accounting for some expenses, investors would want to take back part of their earnings. Similarly, foreign nationals who work in one country may also want to save some part of their income to take back with them. Hence, barriers to remittance of earnings may discourage investments.
While, keeping capital safe is an issue, it is the second subject in the process of industrialization; the first being introduction or creation of said capital. Industrialization is a discrete process and it develops one firm at a time. Since firms are dependent on each other, because no single firm can produce everything it needs, the improvement of one firm requires some participation from other players as well. Hence, even miniscule changes in one firm may have profound effect in the industry output. Therefore, each individual effort is of great importance and all such endeavours should be entitled to an opportunity of facing the market. However, the market is a harsh place and inefficient or unworthy firms are automatically eliminated and the government should, in no condition, intervene in the decisions of the market.

Restrictions in the form of minimum capital requirement do not guarantee that firms will greatly benefit the host country. Similarly, there is little room for arguing that one large investment will definitely benefit the country more than multiple smaller investments. Likewise, minimum capital requirement do not ensure investors of large returns or efficient management. Minimum investment requirements simply add a barrier to small and medium sized investors (Ghossein et al, 2013).

Investors from home and abroad should also be allowed access to funds from sources outside the country. While current account convertibility exists, it is important to also allow the conversion of capital assets into foreign money and, likewise, the conversion of foreign money into capital assets in Nepal. Such provisions, through a gradually eased conversion process will allow room for “investment, funding and hedging opportunities of the private sector (Schneider 2000).”

C. Investment security

Investment security and profit generation are important issues of concern for an entrepreneur looking to start any enterprise. While profits are important for a firm to pursue activities such as expansion, research and development, and other related tasks, firms cannot outweigh the
importance of keeping their capital—human and physical—safe from dangers and risks. Moreover, no business can come into existence without the use of such capital. In other words, the wealth that firms employ and create serves to identify the company. The importance of safeguarding and protecting such valuable resources cannot be stressed enough.

   Businesses, once established, need some form of assurance that their investments will be protected. Similarly, firms will require some form of dispute resolution to take actions on any difference that may arise. Investors will feel secure if they can be assured that their capital will remain in their own control once an investment is made, as unforeseen nationalization or price controls will unduly disenfranchise firms.

   It is especially important to structure and organize policies in a clear and concise manner that is easy to comprehend and does not leave much room for doubt. While a large and long policy document may appear to cover all the necessary topics and properly elaborate policy needs and demands, a short and clear document can also avail related information regarding the country to potential investors. Edmiston, Mudd, and Valev in their paper *Tax Structures and FDI The Deterrent Effects of Complexity and Uncertainty* maintain that tax laws that are unclearly worded, have indeterminate language, or are prone to inconsistent changes have a “significant negative effect in inward foreign investment (Edmiston et al 2003).” They argue that ever-changing and unclear laws and acts impose large transaction costs during establishment as firms have to be able to comprehend the document. Similarly, it creates a hazardous environment if investors are not encouraged, by the act, to be sure about the fate of their earnings or property (Edmiston et al 2003). On top of discouraging investment activities, such hazy provisions may also propel more firms into the shadow economy to stay under the radar of such unclear acts.

   One of the best means of presenting investor-friendliness is through bilateral treaties. Such treaties “contain provisions on the admission and establishment of foreign investments, standards of treatment, expropriation or nationalization measures, transfer of income and capital, protection
of investment agreements or contracts, guarantees granted to foreign investments by home state agencies, and dispute settlement mechanisms (Handbook 2010).” Nepal, however, is one of the poorest performers in signing Bilateral Investment Treaties (BIT) with only 5 treaties in place.

The decision of foreign firms on investing in a country also depends on their ability to leave their host country. Efficient policies will not only allow investments to enter the country, they will also empower investors to take advantage of their earning as they please. Multinational Corporations (MNC) may use the earning from one geographical area to expand production to other areas. Similarly, an unsuccessful venture may also be able to avert large losses by liquidating assets and starting a new establishment in another area. Hence, the easy movement of entrepreneurs and their monies is an integral part of a successful investment regime.

**D. Judicial System**

Nepal has arbitration centers and all disputes that arise within or between firms seeking out-of-court mediation need to follow the Arbitration Law. Given that formal legal systems usually involve tedious processes, arbitration and mediation are efficient means to settle differences in a timely and cost effective manner.

According to the World Bank’s Doing Business report, it takes 910 days, 39 procedures, and costs 26.8% of the claim to enforce and come to a judgment of a contract (WBG, 2014). Such time and monetary requirements may greatly exacerbate the costs involved in resolving any dispute. In Nepal, to stay away from such long and tedious proceedings, businesses employ informal or word-of-mouth relations (Krishnan et al, 2013). However, such options may not be open to foreign investors. Hence, it is important to create and facilitate institutions that serve alternate dispute resolution mechanisms.

Before discussing the proposed policy draft, to colour Nepal’s FI policy it in its correct hue, let us briefly look at related provisions from Costa Rica, Ghana, and Mauritius.
In **Ghana** the 1983 Structural Adjustment Program was responsible for easing trade, disassembling the license regime, removing tariff barriers, and reducing the opportunities for black market operations (Enu, Havi, Attah-Obeng, 2000). Their liberalization regime proved successful in curbing the underground economy and, hence, increasing the transparency of the economy overall. The 1983 program helped to ensure that private property, especially intellectual property, was properly safeguarded which helped to increase the attractiveness of the country to foreign and domestic investors alike (Enu et al 2000). In 1985 an Investment Code was created which led to the establishment of the Ghana Investment Centre which was responsible for the promotion and regulation of investments and for the removal of all forms of discrimination between foreign and domestic firms.

While the Ghanaian investment code was pivotal in attracting more foreign investors in the market, there were significant barriers to entry in a number of sectors due to various state run enterprises monopolizing over these fields. Hence (in light of excessive bureaucracy, a lackadaisical attitude towards state activity, lack of entrepreneurial drive and acumen, poor incentives for proper management, and low working capital and investments) 1988 saw the rapid privatization of inefficient state run enterprises. This move led to a rise in efficiency, output, employment, and income (Kyaku, Asante, Gyasi 2000).

There were also revisions made to the agencies involved in FI regulation and promotion in 1994 when the Ghana Investment Promotion Centre was established. This new agency was solely responsible for the promotion of FI and also spearheaded a new liberalization regime. The same year, Financial Sector Adjustment Program (FINSAP) was established which led to the stabilization of interest rates and control of inflation rates, further, enabling a stable environment for investments (Kyaku et al 2000). On top of a financially secure working environment, the Ghanaian labour market is also an attractive feature to foreign firms. The rank and file members of unions are regularly involved in education programs which has helped increase accountability and structured an atmosphere of responsibility among local workers (Kyaku et al 2000).

In **Costa Rica**, a highly skilled and educated labour market has played an important role in attracting high quality manufacturing related
FIs. Now, the country has graduated from producing a few specialized commodities into exporting more than 3000 goods and services. Moreover, the goods exported are comparable with the outputs of developed nations. While years of large investments in the education and health related sectors have played its part in enriching the labour force of Costa Rica, the education system is particularly inclined at making students job-ready as schooling is catered towards academic and vocational training. The skills and specialization exhibited by the labour force have made the country an attractive area for investments in low-wage/low-skill and high-wage/high-skill industries.

The FI related bureaucracy is extremely well organized in Costa Rica as the Ministry of Foreign Trade (Ministerio de Comercio Exterior (COMEX)) enjoys different privileges than other ministries. COMEX is “small, pays better, hires better professionals, and can hire and fire at will”. This agency is in charge of creating a competitive business climate for export related activities (Trejos, 2014). The Trade and Promotion Agency (PROCOMER), which lies under the jurisdiction of COMEX, is catered towards marketing the benefits of export to domestic firms, disseminating market intelligence to reduce information asymmetry, providing advisory services for small exporting companies, and organizing promotion events for buyers to see Costa Rican products (Trejos, 2014). Moreover, the promotion activities are conducted on a small one-on-one basis or industry wise basis which has helped increase credibility and, simultaneously, reduce advertising expenditure. The most unique feature is, however, the Costa Rican Investment Promotion Agency (CINDE) which was established with the funding of USAID (Trejos, 2014; Cordero et al, 2008). This non-government agency’s main function is to train and encourage small agricultural exporters. It also spearheads promotion activities for Greenfield investments within the country and acts as an information bridge between country and investors. CINDE has been lauded as one of the most successful investment promotion agencies in the world (Trejos, 2014).

The success of these investment related agencies is also attributed to the autonomy these departments enjoy which has helped increase accountability through the proper delegation of responsibility (Trejos, 2014). The legislation of Costa Rica has also made arrangements to
provide for the employee welfare through the mandatory provision of insurance and severance pays. Similarly, the labour force of Costa Rica has limited union participation and unions are organized in a firm-wise basis rather than industry-wise which is commonly seen in other parts of the world. The small size of the unions has also contributed to an enhanced communicability between employees and employer (Trejos, 2014).

**Mauritius** also has good practices that Nepal would do good to look into. Through provisions such as a flat tax of 15% on personal and corporate earnings to the possibility of opening up a new business within 3 working days, Mauritius is one of the most accessible countries to foreign investors in Africa (Zafar, 2011). The country, once known for its monocrop export base has now restructured itself to accommodate investments in manufacturing, offshore banking, and other services. Most of these changes are attributed to the government of Mauritius’s approach to act as a facilitator rather than the regulator of foreign investments. The country’s government has moved further away from interventions by introducing market mechanisms such as weekly auction of treasury bills rather than set ceilings on credit rate. Similarly, legislation protects all investments from nationalization (Zafar, 2011). The friendly business climate is further augmented by complete convertibility of current account and capital account and interest rates that exhibit a positive rate of return on savings which has helped increase domestic saving. Similarly, free schooling up to university level and improved infrastructure has greatly contributed to encouraging investments within the country. The Competition act of 2007 has also enabled a competitive environment to facilitate the ease of entry and exit of firms (Zafar, 2011).

The government of Mauritius holds regular meeting with the Joint Economic Council, which is composed of representatives from the private sector, in order to share information between the private and public enterprises. There is no differentiation between domestic and private investors and all businesses have to be registered at the Registrar of Companies in order to receive a certificate of incorporation. Once the required document is received, a registration at the Board of Investment completes the procedures related to establishment (Zafar, 2011).
III. The Foreign Investment Policy

1. Institutional arrangement for FI approval

The Foreign Investment Policy, 1992 and Foreign Investment and Technology Transfer Act (FITTA), 1992 enabled the Department of Industries (DoI) and Industrial Promotion Board (IPB) as the main bodies for approval and related functions regarding foreign investment; wherein, the former delegates with “investments with fixed assets of up to Rs.500,000” and the latter with those exceeding the mentioned amount (FITTA 1992, and FIWOP 1992). The Foreign Investment and One Window Policy (FIOWP), 1992 established the DoI as the one window servicing agency and instated the IPB as the governing agent. The new FIP draft, however, calls for more institutions to be involved in the process. Apart from DoI and a restructured IPB, in the form of a 20 member Industry and Investment Promotion Board (IIPB), Ministry of Industry (MoI), Ministry of Home (MoH), Department of Labor (DoL), Labor Office and Department of Immigration, Nepal Rastra Bank, and Investment Board of Nepal (IBN) are also involved in different phases. It appears that the DoI is bestowed with a number of responsibilities such as: registration, administration of FIs, and evaluation of technology transfer practices, facilitating foreign investors and employees with visa related issues, coordinating communication with Nepal Rastra Bank (NRB) with currency and repatriation related issues, evaluating the environmental impact of the proposed plans, and evaluating and communicating with projects that have been approved by the department. However, it is not clear if the DoI would be designated as the one-window as mentioned in the 1992 one-window policy document.
The “One Window,” if not effectively administered could very easily become one more window, thereby, adding to, instead of easing, the bureaucratic process. The new FIP draft visions the one window as a service centre for ventures that have already been established or approved in Nepal as its primary duty is to provide incentives—that have been allotted in the FIP draft—to existing industries, and to provide service and help with infrastructure related issues. With such reasoning, it appears, that the new one-window service centre will indeed become one more window as such institutions would be most effective if their responsibilities are catered towards facilitating entry of FIs rather than assisting existing institutions. To truly assist foreign investors, and to assure potential investors of a receptive climate, ease of entry and exit should be prioritized, which seems to be overlooked by the currently proposed draft. For example, foreign investors doing business in Nepal need to acquire business visa, during which, the application has to pass through a number of channels, namely, Department of Industry (DoI), Ministry of Industry (MoI), Ministry of Home (MoHA), Department of Labor (DoL), Labor Office and Department of Immigration. Furthermore, the application-processing can take as much as 15 weeks or even more. Such procedural delays would not only deter potential investors, it would also add unnecessary hassles for institutions already established in the country.

Procedures have been made more intricate compared to the existing policy. “Large” investments are to fall under the jurisdiction of the Board of Investment (BoI) while investments that do not fall under the BoI’s responsibility will be approved by “either” the IIPB or the DoI. Moreover, it is not clear if both agencies will be involved. Similarly, MoI is the administrative agency for FIs including those approved by IIPB and DoI as it follows-up and evaluates the FIs approved by both IIPB and DoI. While FIWOP 1992 has already made the provisions for DoI to act as the one-window, creating new bureaucratic chains by assigning comparable tasks to different institutions only creates more complexities. Moreover, coordination between various government bodies of Nepal has been found to be poor time and again. The rationale of one window policy is undermined by erecting several institutions placed to perform similar tasks.
2. Investment threshold

The new FIP draft does not impose restrictions on the amount of money to be invested in any industry. Previous policy also did not enforce financial restrictions of any kind for foreign investors. Such restrictions, if imposed, can be a serious drawback for improving the investment climate as new investors may not be keen on investing large sums on relatively new markets.

3. Visa and entry permit

Foreign Investment Policy 1992, FITTA 1992 and FIOWP had provisions of business visa, resident visa and non-tourist visa ranging from periods of 6 months to active life of investment, depending on nature of investment. The Foreign Investment Policy 2014 draft has made provisions of business visa for 5 years, subject to renewal, resident visa for investors investing over $1 million at once, till investment is active, and non-tourist visas, according to need, for conducting feasibility study. DoI has been assigned as the body responsible for assuring interdepartmental communication by providing recommendations for the immigration department and labour ministry for foreign investors, employees, and family members.

While the draft acknowledges the need to provide employment to foreigners, should labourers with the required skill set not be available in the country, it limits the tenure of employment to 5 years. This limitation might undercut the rationale of technology or skill transfer as the allotted time period might be insufficient for such transfers.

4. Facilities, rebates and other incentives

The proposed draft has many clauses providing various fiscal and non-fiscal incentives for foreign investors which are on par with, if not better than, domestic investors'. Provisions of income tax exemption,
reimbursement of custom and excise duty on raw materials, and similar fiscal and non-fiscal incentives were included in FIP 1992 and, the now defunct, FIOWP 1992 while no such provisions are mentioned in FITTA 1992. Similarly, as Nepal is in the process of adding new Special Economic Zones (SEZ) and Export Processing Zones (EPZ) the proposed act promises to promote the establishment of industries in such business districts. The draft limits procedural requirements of investors looking to invest in SEZs and EPZs by simply having them register at DoI.

The policy offers both fiscal and non-fiscal incentives such as income tax exemptions and privileges on import tariffs, and permanent resident visas for investors and their dependents. Staying true the act’s goals of promoting technology transfer and utilizing Nepal’s labour to establish the nation as a prominent exporter of goods and services, the proposed draft has provisions for: providing tax breaks on research and development activities (that benefit the nation), subsidies on projects that are harmonious to energy and infrastructure development, tax breaks for expansion activities financed from profits, and subsidies for utilization of local products that undergo value addition for export activities. Similarly, the act assures that actions will be taken to protect investors from heavy tax burdens by establishing relations with the investors’ nations to promote double tax avoidance treaties. The draft also recognizes “forward contracts” as a means of mitigating currency related risks.

However, as these “incentives” are mentioned in the investment code, conflicts could arise between the former and the country’s tax code, which, could not only confuse investors, but also make it difficult to administer them. This allows greater discretionary powers to tax administrators and related officials. Another consequence of such unclear clause can be lobby groups and special interest groups exploiting such loopholes. Moreover, incentives should be non-discriminatory between foreign and domestic entities and should promote industry establishment in general.

There are also ambiguities in the FIP draft that need to be clarified so that investors have a clear idea of the incentives involved and to ward off
any potential exploitative investment activities. Some unclear sections are: the clause in which GON is to provide equivalent facilities and incentives to the foreign investors does not clarify about tax rebates; the clause on complete exemption of income tax as per COD for foreign investment in hydroelectricity and physical infrastructure does not mention the time duration for the exemption; the amount and duration of cash subsidies to be provided on construction materials for hydroelectricity and physical infrastructure has not been mentioned; and the duration of the corporate tax rebate on reinvestment of profit has not been mentioned.

The incentives provided to the foreign investors could attract a lot of paper based investors who are focused on the provided facilities rather than bringing proper investment in the country. These kinds of loopholes create room for rent-seeking, thus, raising the cost of doing business.

Overall, the proposed clauses make room for arbitrary favours.

5. Foreign workers

None of the previous policies of 1992 had any provisions regarding foreign workers while the latest FIP 2014 draft mentions that foreign workers can only be employed if the skills required are not available within the country.

FIP draft sets a condition that as long as a Nepalese citizen can do a particular job he/she has to be preferred to an expatriate. Foreign workers may only be hired if individuals with such skills are not available in Nepal. Such approval is to be secured from the Ministry of Labour (MoL). After hiring a foreign worker, the investor also needs to guarantee that such expertise is transferred to a Nepalese citizen so that a domestic worker may replace the foreign worker within five years. This condition takes for granted the complexities that can arise when a Nepalese citizen has to be an expert himself/herself in latest managerial and technological developments from around the world. This clause makes room for instating under-qualified experts into challenging posts, consequently jeopardizing industrial relations.
6. Industrial security

The FIP 2014 draft has provision for industrial armed forces for industries under foreign investment and also includes the provision of police beats for foreign owned industries employing more than 500 Nepali workers. Industries with less than 500 workers are also equally important for the economy hence their protection is equally important. Similarly, the new draft also communicates the need to provide a stable working environment for foreign owned enterprise by curbing disruptive behaviour ex-ante through due process of law. The previous policy FITTA, FIP 1992, and FIOWP do not have provisions regarding industrial security.

Foreign investments are particularly sensitive to issues such as political stability and property rights guarantees. An unstable political environment might hint at aggressive rent seeking behaviour from agency heads, as they might want to capitalize on the short duration that they expect in office. Likewise, weak property rights would indicate possible loss of physical and intellectual property. Hence, the government should attempt to stabilize the situation throughout the country’s political, social, and economic environment rather than provide security in niche areas.

7. Nationalization and confiscation

The Foreign Investment and One Window Policy 1992 had clearly mentioned that industries under foreign investment are not to be nationalized whilst FITTA 1992 and FIP 1992 had no provisions regarding this matter. While the FIP draft, under its “strategies” section, indicates that no industry established under foreign investment will be nationalized, the “guarantee and facilities” section mentions that under compelling circumstance related to public safety and benefit, (GoN) may nationalize investments by providing due compensation. However, there is no mention of what such compelling situations may be.

Nationalization clause puts foreign investors at the risk of uncertainty as their property rights may not be safeguarded by law. When
an investment policy creates an environment where as much as cent percent of an investor’s property can be forfeited, it may act as a warning signal to investors and coerce them to resist making investments in the host country. As the policy further defines the conditions under which FI-owned property can be subject to nationalization rather ambiguously, it allows unrestrained discretionary powers to the government as to when to nationalize an FI and why.

The clause of nationalization and confiscation of foreign owned enterprises under ambiguously presented public interest issues like national security, public health, and environment may become a hindrance for bringing foreign investment in the country. This clause could setback the number of investors willing to bring capital due to uncertainty.

8. Repatriation

FIP 1992, FITTA 1992 and FIOWP 1992 have made provisions such that a foreign investor can repatriate as much as 100% of the earnings made by making investment in Nepal. They also ensure that as much as 75% of the earnings made in the form of salaries and wages can be sent back in convertible foreign currencies. The FIP draft gives continuity to the same provision but in the meantime, adds new terms whereby the expatriates have to take approval from MoL prior to repatriation of such salaries and wages.

Foreign employees of foreign owned enterprises are only allowed to work in Nepal with prior information to the Ministry of Labour and approval of the same as the Ministry requires detailed information on the foreigners working in Nepal. And, since, the repatriation of salary is done through NRB it too acquires the duty of maintaining records on employees. While the role of MoL is to confirm that the foreign worker is hired only in the case where no Nepali citizen is able to perform the same job, NRB is required to maintain necessary records on investors and employees looking to repatriate their incomes. It seems inconvenient for these workers to go through similar approval processes from different channels, namely, MoL and NRB. The sound implementation of the repatriation policy will,
therefore, only be possible when the two departments maintain efficient and effective communication (Myanmar-Business Guide” 2014).

9. Dispute settlement

Prior foreign investment policies state that the first tier effort into dispute settlements is to be made via mutual consultation in the presence of DoI. Failure to settle disputes thus are allowed to undergo arbitration as per the United Nations Commission on International Trade Law (UNCITRAL) code. Above all, FITTA 1992 and FIOWP 1992 state that in case of investments of a “specified amount” dispute settlement process can be undertaken as per the FI agreement, but it makes no move to elaborate what the amount would be. Along the same lines, the proposed FIP draft goes on to establish FIs worth $ 10 million to be the minimum permissible FI wherein dispute settlement as per the FI agreement can be allowed. Similarly, both Nepali and English are acceptable languages for the arbitration process and required documents.

However, there are no explanations supporting the need of the $10 million benchmark as a minimum requirement for dispute settlement according to FI agreement. If all disputes arising in foreign or foreign and domestic owned enterprises were allowed to be settled according to the FI agreement, it could provide a suitable climate as the concerned parties would be in even terms regarding the terms of agreement. Moreover, settlement processes according to the Labour Act of Nepal could take much longer than those accorded by the FI document. The industrial relation in all foreign owned enterprises would be better if disputes are settled through foreign investment agreement.

10. Ban on strikes

The proposed FIP draft has made arrangements for an outright ban on strikes within Special Economic Zones (SEZs) and Export Processing Zones (EPZs). None of the former policies stipulate such restrictions on organizing and protesting.
While the issue itself is more pertinent to labour codes than FIP, it is a violation of GoNs guarantee to Nepalese citizens as well as of Nepal's international commitments. This clause violates the constitutional right of every Nepalese citizen to organize and protest. Outright banning of strikes is also against the principles of International Labour Organization (ILO) which recognizes workers' right to organize and strike. Two resolutions of International Labour Conference have also emphasized upon this right. “Resolution Concerning the Abolition of Anti-Trade Union Legislation in the Member States of the International Labour Organization, 1957” calls for adoption of laws that ensure effective and unrestricted exercise of rights of trade unions which includes workers’ rights to strikes. “Resolution Concerning Trade Union Rights and Their Relation to Civil Liberties, 1970” invited government bodies of member nations to ensure universal respect for trade unions’ rights in their broadest sense, including right to strike (Gernigon, Odero & Guido, 2000).

Furthermore, various ILO committees have stated time and again that right to strike is a fundamental right of the workers as it allows them to legitimately promote and defend their economic and social interests. Having such a clause in the FIP can have a negative impact on the power balance factor pertaining to industrial relations as such laws may greatly reduce workers’ abilities to enforce their collective bargaining powers in cases where rights of workers are violated. This may further reduce the chances of maintaining a cordial and harmonious labour relation.

11. Bilateral Agreements

FIP 1992 and FIOWP 1992 acknowledged the government’s interest for signing Double Taxation Avoidance Agreement (DTAA) with foreign investors to protect them from possible cases of double taxation on their incomes. Proposed FIP 2014 has prioritized signing Bilateral Investment Protection and Promotion Agreement (BIPPA) in addition to DTAA with countries that have FI presence in Nepal.

Nepal has signed Bilateral Investment Protection and Promotion Agreement (BIPPA) with five countries and still counting. This agreement
states that the host country is to be responsible for the losses incurred by the FI due to war, armed conflict, or emergency in the host country. In such cases, there is a legal provision that Nepalese investors need to be protected and compensated by the host country in the aforementioned cases. However, Act to restrict Investment Abroad 2021 is still effective in Nepal, which ultimately bars Nepalese investors from investing abroad. While this is a case of policy incongruence, overall, issues related to investments cannot be fully resolved by a policy that looks solely over inward Foreign Investments without making necessary amendments in related policy documents.

12. International commitments

Proposed FIP 2014 has committed to honouring WTOs trade in services code. Nepal's WTO commitment requires that Nepal open up 10 service sectors and 70 service sub-sectors for foreign investment (SAWTEE, 2011). These service sectors include business services, communication services, construction and related engineering services, distribution services, education services, environmental services, financial services, health related and social services, tourism and travel related services, recreational culture and sporting services, and transport services. Up to 100% of FI is allowed in these service sectors. Under GATS, Nepal has committed to allow no subsidy to any enterprise that has any foreign investment, however, the new draft mentions that foreign owned enterprises will have access to the same facilities as domestic investors. A contradiction to WTO agreement can also be seen where the new FIP promises subsidies for export activities that rely on domestic raw materials and see value addition in excess of 50% of value. Incentives and subsidies provisioned to FIs under this policy violate the GATS commitment.

13. Forms of Investment

Foreign investors have been categorized as Organisational foreign investors, Individual foreign investor, and Non-Residential Nepali Foreign Investor. These different groups, in turn, are restricted to the kinds of investments they can make. Organizations can conduct direct investments and investments in the secondary market. Individual foreign investors are not allowed to invest in the secondary market and Non-residential Nepali investors can practice direct investments and investments in the secondary
market. The draft, however, stipulates that organizations investing in the secondary market can only sell the acquired assets after a period of three months.

The fundamental of security markets is that an investor can buy securities at any time and can redeem his/her investment at any time as per his own discretion. Restricting an investor from redeeming his investments made in securities markets is against the fundamental of the market. This can act as a discouraging factor for possible investors.

14. Price fixation

FIP 1992 and FIOWP 1992 had provision that stated that no intervention would be made in fixing the prices of products of foreign owned industries. FIP 2014 draft has provisions where the government can issue directives on matters concerning public interest such as public health.

Since a lot of issues would be concerning public interest and the government could arbitrarily issue directives on any products stating it to be in public interest, such provisions could be discouraging for because of the underlying uncertainty.

15. Provision for exit

FIP 1992, FITTA 1992 and FIOWP 1992 have no provisions regarding exit of foreign owned industries while the new draft has made provisions for exit with approval of DoI, BoI or MOI, as per whose jurisdiction they fall under.

The proposed FIP 2014 has aimed at attracting big investments, specifically those that are made for a long term. But when a policy creates a situation where an investor has to take permissions to redeem the investments, thus increasing costs and uncertainty of benefitting from the market opportunities elsewhere, the investor is discouraged from making investment in such host countries in the first place. Increasing the number of steps to exit from a market can, thus, restrict the amount of inward FI.
IV. A Case in Nepal

Foreign investments are not a one sided affair. While a government’s intent or aspiration for Foreign Investments (FI) can be evaluated from the Foreign Investment policy (FIP), the rate or incidence of FIs occurring in the country provides a solid view of the country from investors’ perspective. Nepal ranks lower than Costa Rica, Ghana, or Mauritius in terms of ease of doing business according to the World Bank Group. Thus, it is not surprising that Nepal also attracted fewer foreign investments than any of these countries (WBG, 2014). However, even countries, like Zambia, Suriname, Bangladesh that rank below Nepal in terms of ease of doing business have performed well in terms of attracting foreign investments (WBG, 2014). Therefore, it pertinent that Nepal not only liberalize the establishment of businesses but also make amendments to the existing regime that may be curbing the proper flow of investments into the country.

An environment that is not restrictive towards foreign investments helps increase the competitiveness of domestic firms and promotes healthy contest between entering investments. These new firms, then, not only encourage the entire market to behave more efficiently, they also add beneficial traits in the market which persist regardless of the firm's involvement. One example of a healthy addition through foreign investments would be the creation of skilled employees. As firms hire local employees, who may be relatively unskilled than those in the economy the investing firm originally belonged to, these individuals will be able to access technology and skills that were virtually absent from the economy. This would then cause the quality of the country’s labour force to remain improved. Research has even shown that the presence of foreign firms,
which almost always pay higher wages than domestic firms, leads to a rise in general wage level (Lipsey, 2002). Similarly, consumers who get used to quality products and services provided by a Multinational Firm (MNC) may permanently change their traits to demand higher quality products from domestic providers as well. Hence, FI can improve markets through their influences on both demand and supply (Kohler, 2010; Asiedu, 2001).

Foreign Investments also provide the host country with valuable information regarding managerial techniques and market information. Underdeveloped countries may be lagging behind due to poor knowledge of world-market and its working mechanisms. MNCs or Transnational Companies (TNC) can play a fateful role in providing host countries with valuable information regarding world markets and they may also be able to provide the receiving country with suitable managerial abilities to properly utilize such information. Foreign firms seeking new resources may, also, find new uses of resources that may be going unutilized. This would then provide the economy with new avenues of adding wealth to society.

It seems that foreign firms are responsible, as in the case of US companies in the East Asian countries, for introducing the host country to the world market (Lipsey, 2002). As it is natural for foreign firms to enter into a foreign market in order to seek resources or to provide for the market demand, the foreign entrants may also provide newer products to the domestic populace or devise new usage of the resources existing in the host country. Lipsey (2002), reiterating Rhee and Belot, states that TNCs “... transfer technical, marketing, managerial know-how to developing countries—a role more important than the transfer of financial resources associated with direct foreign investments by TNCs.” He introduces examples such as the introduction and huge success of plywood manufacturing in Indonesia after Korean firms introduced this activity when producing plywood became prohibitively expensive in Korea due to rising wages. The success of a military uniform exporter in Zambia which was established as a joint venture but later became able to conduct export activities on its own accord is also an example (Lipsey, 2002). Such instances provide a real world view into the advantages that Nepal can reap
from the participation of foreign firms in our local economy. However, in response to the debate on the level of specialization needed by host country firms to take advantage of technological spillover, it has been shown that the benefit of such spillover can be greatly enhanced if domestic firms are not very primitive (Lipsey, 2002). Hence, it is high time that reforms are immediately introduced in Nepal to increase competitiveness and allow more and more entrepreneurs to participate and learn from the market.

To sum up, the benefits of FDI do not simply end at the amount of money or capital that was brought in from an outside source. The benefits of such investments are multiplied many folds as different groups will benefit from the newly created wealth: the investors benefit from profits, consumers benefit from the goods and services they purchase, the availability of products from within the country may help reduce imports, foreign currencies used to start enterprises will help increase foreign currency reserves, residents will find employment, demand for high quality workers and service providers will, in turn, make other firms more productive and may create better education institutions to enrich human capital, and the list goes on. Therefore, it is important to view FDI not only as a means of bringing money in the country, but rather, as an effective promoter of cross-sector development.

1. Good Practices in Nepal

The new FIP draft has a dedicated Industry and Investment Promotion Board (IIPB) and separate regulatory bodies, namely DoI, and MoI. Regulatory bodies are compliance related and may even have to adhere to the ideologies of the ruling party. Promotion bodies, on the other hand, have to remain “market focused” and have a strong grasp of marketing and business practices. Whyte, Orgeta, and Griffin in their paper Investment Regulation and Promotion: Can they Exist in One Body?, from the World Bank Group’s Investment Climate in Practice series argue that economies that have separate regulatory and promotion bodies fared much better than the ones that had a single unit performing both activities. They reason that since regulation and promotion are distinct tasks with separate goals, a single
agency performing both functions may contradict its own actions and send mixed signals to potential investors (Whyte et al, 2011). Granted that the current framework of institutions is better theoretically, it does little to assuage our doubts regarding why such institutions need to exist in the first place. All businesses have to be registered at the Company Registration Office (CRO), thereby, eliminating the need of the DoI. Similarly, a good institutional framework that supports private investment will show an active domestic business base which leaves no reason for the IIPB to exist.

The new FIP draft also does not have any minimum set-up requirements for foreign owned investments, meaning that investors are not restricted to investments over or under a certain amount of money. Small and medium sized enterprises (SME) are valuable carriers of development and exhibit scope for growth. While, large enterprises may show signs of economies of scale and may be more efficient at utilizing resources, there is little more evidence to support why a large, new, venture may be better than two smaller projects in different locations whose values add up to the same amount or how a small venture may not become more beneficial to the host nation in the long run. For example, in the Information Technology (IT) sector, businesses can be established with relatively little investments and very little time. Moreover, such businesses are not affected by shortages in infrastructure such as inadequate roads. Even large, risk loving, TNCs may want to invest in small amounts before adding large amounts of capital in an unfamiliar territory.

A country’s involvement in various bilateral or regional level treaties also helps shed a better light on the investment climate. Such treaties and agreements impose a set number of rules and regulations that helps to ease the entry of firms and also loosens the requirements for the firms under operation in the country. Nepal’s entry in the WTO and its intent to step into bilateral treaties with other nations definitely improves Nepal’s FI credibility.

Many FIs also start as Greenfield Ventures, meaning that they are not confined to one aspect of the market in the long run. Greenfield operations
do not have a defined scope and depending on new demand, availability of resources or technological advancement may expand to other areas of the economy. Hence, emphasizing on large investments could cause the country to lose out on projects that have the possibility of becoming major employment generators or service providers.

As a means of attracting foreign investors, the GoN has also made provisions to provide investors with various fiscal incentives. Sebastian James in the paper *Providing Incentives for Investment*, which was published by the World Bank Group, argues that incentives should be provided to projects that contribute to positive spillover effects and externalities as the effects of such incentives will permeate to the rest of the economy as well (James, 2009). The new draft has set up incentive programs for investments in research and development, development of infrastructure and other similar undertakings. “Such investments can have positive, often long-term spillover effects on the economy or environmental protection, making it easier to justify spending on investment incentives (James, 2009).”

Here, too, one must keep an open mind in order to comprehend the actual effects of such incentives. Incentives provide many opportunities for unscrupulous actors to influence the incentive providers to use incentives for their personal gains, i.e. incentives provide opportunities for rent seeking activities (Bahgwati et al, 1984). While providing the best incentive may seem like a sound coercive tool in light of the multitude of nations providing such incentives the fact that such facilities are economically unsustainable should not be overlooked (James, 2009). Therefore, incentives should always be temporary in nature and should strictly be addressed in the country’s tax code as such practices will lessen the risk of contradiction between similar provisions from different statutes (James, 2009). Moreover, incentives have many indirect costs associated with them. While the government loses the possibility of generating revenue through taxes, it may be increasing expenditure by providing incentives. Similarly, new businesses that are not economically viable may be established simply to take advantage of the underlying incentives (James, 2009). In conclusion, incentives are not a proper option for the investment code. If such programs
are indispensable, then they should be of temporary nature and only be addressed in the country’s tax code.

2. Room For Improvement

There are many aspects of the FIP draft that may pose as potential barriers and prevent the liberal entry of foreign firms in the country as even policies that are not aimed at regulating FI may, in some manner, discourage adequate investment. Government policies that impose rigorous procedures in business registration and licensing greatly affect the entrance of both domestic and foreign investors as they add to start up costs and increase the time it takes to start a business. Moreover, considering Nepal's recent past, one entrenched in conflict and instability, coupled with the current shortcomings in infrastructure, a perceived difficulty in starting new business may have detrimental effects in the amount of FIs coming in the country. Nepal, also, does not have the best image in terms of a clear and supportive political climate. So, one of the first steps that need to be taken for improving foreign investment is to improve conditions for businesses in general.

In Nepal, foreign investments, as compared to domestic ones, have to go through more processes before being able to establish and conduct businesses. Reducing discrimination between domestic and foreign investment ventures will be greatly beneficial in improving Nepal's image among foreign investors. In meetings conducted by Samriddhi with investors currently active in Nepal, many expressed dissatisfaction with the services provided by the DoI and the Ministry of Labour. Currently, under the existing laws, foreign investors and the foreign employees that such ventures feel they need—because of the unavailability of persons with the required skills in Nepal—have to undergo interviews with the Labour department; meaning that foreign investors have to go through at least one extra channel without any idea how long the required processing will take to finally give them the green signal to start investment procedures. Such dealings, which may seem innocuous to policy makers, might have an insidious effect on investors.
Similarly, the FI draft’s pledge to treat foreign investments equally as domestic investments is also not reflected by the establishment of the DoI as a regulatory agency. Since FIs, like domestic investments, have to register their businesses at the Company Registration Office (CRO) and as the CRO gets all the necessary information regarding the business about to be established, the work of the DoI simply feels redundant. Moreover, it only creates one more channel for FIs to navigate thereby increasing the institutional burden they have to face. And this is only one instance where the policy does not really exhibit a non-discriminatory treatment towards FIs.

By virtue of being foreign, investors eying the Nepalese market have to undergo visa and other immigration requirements; a process, that many investors have decried to be unsatisfactory and unpredictable. It is a burden attributed especially to the inefficiencies within the Department of Immigration, which falls under the jurisdiction of the Ministry of Home Affairs, and the Ministry of Labour. These entrepreneurs have to wait for long periods of time before their documents are processed and the applicants given any decisions. Such procedures, if carried out in an untimely manner will create an unfriendly environment for investors and their workers. An investor currently residing in Nepal has pointed out that visa processes take as long as 4 months even for renewal.

Both entry and exit requirements are important aspects of FDI policies that affect FIs. While entry barriers may seem to be the bigger hurdle between the two, it is unlikely that an entity will invest in an area only to have the investment be frozen in the location. Hence, harmonization of the two characteristics is essential to ensure the ease of entry into a particular country location and to warrant adequate control of the investment to the patron. The new FIP draft requires all investments intent on exiting the country to request for permission from the agency that granted them entry. An ideal policy would allow the dissolution of an enterprise through the Company Registration Office alone as extra channels of permission seeking simply add more procedure on the part of FIs and expose the government’s segregated view towards FIs.
In the case of Nepal, the liquidation process is long and requires many steps. 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. Upon reviewing both Insolvency and 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 lack of implementation mechanisms leads to a liquidator not being able to internalize 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 (Chalise, 2013).

Besides entry and exit requirements, other provisions that directly affect private property and private decision making occur through regulations in pricing mechanisms and laws regarding the nationalization of private property. The new FIP draft sees both price fixing and nationalization to be allowable in matters related to public health and national security. However, such provisions need to be concretely worded to ensure that investors are made aware of the exact scenarios wherein such actions could take place. The best provision, however, is to disallow such takings to occur at all.

The government of Nepal identifies FIs as a means of generating employment and establishing a healthy private sector. So, to prevent foreign firms from hiring too many foreigners, and taking away local jobs, the GoN has fixed a cap on the number of years a non-national may work in the country. According to the new FIP draft, FIs may only hire foreigners if the required skill is not available in Nepal and when such persons are hired, the firm should take adequate steps to replace the foreign worker with a
domestic citizen within 5 years. However, acquiring a visa seems to be one of the biggest hurdles implying that it is difficult for firms to welcome foreign experts in the first place. While, the government feels that restricting foreign workers will compel firms to hire Nepalese workers in their stead, it appears that, in the IT industry, bringing foreign experts actually helps to create jobs for Nepalese workers. Given the infancy of the Nepalese market and capital base, it is not very farfetched that foreign experts are needed to expand business processes, and manage and supervise the tasks that Nepalese labourers are capable of doing.

In order to expedite the FI approval process, the new FIP draft has stated and made clear its intensions to establish a “one-window service centre” to facilitate investors in starting a new business in Nepal. However, it appears that this service centre is mainly established to cater to the needs of businesses already established in Nepal, thereby, undermining the rationale of a one-window servicing centre. A similar provision was also introduced by previous policies (FIOWP, FIP) which never came to fruition. Hence, it is not just a matter of laws and provisions that describes a country as investment or business friendly, matters like public accountability are very important to etch confidence in foreign investors.

Still, it is not just about how much the government supports or promotes investments: investors want policies that allow them to carry out their actions according to their own devices in a safe business environment—investments are most effective when investors are simply provided with a map that tells them about the sectors and areas they can access, organizations do not need anybody reciting the map for them. The new FIP draft’s provisions, through incentives, in some fashion attempt to dictate the path that investors ought to take while also attempting to advertise Nepal’s friendliness. However, such encouragements are only effective when the “investment climate” is also supportive of businesses. Research has shown that countries with weak investment climates attempting to compensate for the unsupportive business environment with incentives only saw FIs rise by 1% of the GDP while countries with a healthy investment climate saw the incidence of FIs increase by 8% of
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GDP (James, 2009). Similarly, through tax holidays and such breaks, James argues, countries simply forgo the opportunity of generating revenue. Moreover, the firms that benefit from tax levies in one country ultimately have to pay taxes in another country. So, such policies simply promote the distribution of wealth without creating any new avenues for wealth creation (Handbook, 2010).

The new FIP draft also has provisions in place for dispute resolution mechanisms and envisions arbitration to be the easiest means of easing dispute. However, the document only allows parties to settle quarrels according to the mechanisms mentioned in the contract for investments above $10 million. Though the new FIP encourages dispute resolution to take place outside of court, restricting dispute settlement through contracts for investments above the ten million dollar mark may suggest weak contract enforcement mechanisms. Similarly, the number of disputes that arise would be reduced if all foreign investments could put forth their intentions on their respective contracts in the first place.
V. Conclusion

Foreign policies are an important placard for a country. These documents describe a country’s standing on issues that are important for the country’s residents and foreigners alike. However, the need for being integrated in world markets is of great importance as it brings with it the experiences and opportunities associated with events that may never take place in one country alone. Research has also shown that countries that are open have shown greater levels of development and specialization than their less open counterparts (Borensztein et al, 1997). Higher levels of growth in more open economies are attributed to backward linkages, greater availability of capital, spillover of technology, and other direct as well as indirect effects of trade and foreign investments. Moreover, the need to be open and receptive to global economic environment is of great importance because of an increasingly enlarging global market and the active participation of many countries in the global playing field in an interdependent manner. Open countries enjoy and demonstrate a great deal of specialization by attempting to offer what they provide best in return for products that other nations build better. In this light, the involvement of foreign firms in a country do not only help utilize existing resources, they may provide one with new avenues of utilizing said resource in a more effective and efficient manner. Foreign Investment Policies (FIP) plays an important role in creating this dynamism as such policies dictate the fate of investors looking for opportunities in a country.

Nepal’s new FIP sets its sight on encouraging a greater private sector participation to utilize the nation’s resources in order to create new wealth. Such resources include human resources and natural (tangible) resources such as water, minerals, forests, and other such physical assets. However, a
strong-armed planning approach incorporated by the government actively misconstrues the ideals posited in the FIP. Policies, whose scope extends beyond the facilitation of resource utilization into the realm of resource control, do little more than attempt to decide what is good for the market. Policies that try to prescribe resources to particular users distort the market in unwanted ways and may have unforeseen and unintended long term consequences. Such errors can easily be avoided by allowing the market to decide who uses what when. An important aspect of industrialized nations and their efficient utilization of resource is attributed to a relatively free market approach.

While no economy is completely free, there are a great variety of degrees of freedoms that entrepreneurs and consumers are subjected to. While most agree that governments should protect peoples’ right to property and ensure some safety against harm, the failure of excessive government control can easily be exemplified through the fall of the Soviet states and China’s rapid growth once it moved away from a centrally planned economy. The market is a much more efficient engine of control than any government as it allows for room for errors and provides opportunities for the players to learn from the mistakes.

While the new FIP draft is aiming for a “second generation of reforms,” adequate and helpful changes will not take place until the planning mentality is eroded and room is made for macroeconomic changes to take place. One of the simplest ways that the government can facilitate private sector participation from within and without the country is to reduce government involvement in market processes and allow the market to correct for any of the discrepancies that may arise. Low levels of public sector involvement will also improve government accountability as it will leave the agencies less responsible for the working of the market.

Similarly, Nepal Rastra Bank should now take steps to initiate capital account convertibility to increase Nepal’s access to funds. The FIP draft acknowledges that Nepal has very low levels of domestic savings and has limited access to capital, and one of the easiest ways to increase the
amount of usable capital in the country will be to allow the parties, who have sufficient capital, into the country to invest it as they see fit. Capital Account Convertibility (CAC) definitely has some negatives—such as high levels of speculative investments during booms and wide spread capital flight during busts—associated with the benefit it brings. However, such ills can greatly be reduced by incorporating adequate financial prudence and gently easing the county into greater levels of convertibility.

Steps should also be taken to slowly ease the leadership into an observatory role and not one of guardianship. In order for the country to mature and compete in the world market, it is important to allow the citizens to mature as well. Nepalese entrepreneurs are well aware of the risks involved in conducting business and it is only by taking such risks and learning from market phenomenon that our entrepreneurs can take a stance in the world.
References


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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 - Entrepreneurship development, Improving business environment, Economic policy reform and 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 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 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.

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06. रासायनिक वातावरण (Nepali Translation of “The Road to Serfdom”)
08. Critical Constrains to Economic Growth of Nepal
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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
15. Foreign Direct Investment: Towards Second Generation of Reforms
16. Industrial Relations An Institutional Analysis
17. Doing Business in Nepal: Ground Realities
18. Analysis of the Performance of the Public Enterprises

All the publications are available in Samriddhi, The Prosperity Foundation and major bookstores in the country.
This study evaluates Nepal’s foreign investment policy regime, especially with regards to the draft of the new Foreign Investment Policy recently brought into discussion. It assesses whether or not this policy sets the right tone for Nepal to attract foreign investments into the country.

While the study lauds potential successes of the policy, it also raises curiosities on contentious issues under different topics addressed by the newly floated Foreign Investment policy document such as institutional arrangements, investment threshold, visa and entry permits, rebates and incentives, provisions for employing foreign workers, industrialization, nationalization, repatriation, dispute settlement, and strikes. The study does so all the while emphasizing that policies on their own are never enough and do not guarantee implementation – several other political economic factors come into play.

Therefore, the study also includes the policy’s provisions to other factors of macroeconomic significance. Some reference is also made to countries such as Costa Rica, Mauritius, and Ghana to highlight the provisions and changes that contributed to FDI inflows in these countries. Finally, it also proposes a few recommendations after having rigorously studied the proposed policy in order to better facilitate Nepal’s foray into globalization.

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