

Investment Policy and Regulatory Framework in Nepal, FY 2073-74 (2016-2017)

Introduction

Due to narrow fiscal space in the government finance and feeble capacity of private sector, foreign investment is essential for developing economies. Foreign Direct Investment (FDI) plays a crucial role in the economy along with other Portfolio Investment as it impacts directly through multiplier effect. Every economy in the world is trying to attract FDI today for which government's conducive policies and business environment is essential. Hence, FDI is one of the key elements required for sustainable growth and development of the country and Nepal is no exception in this regard.

The initiation for FDI was taken in Nepal in 1981 through the Foreign Investment and Technology Transfer Act. After the political change in 1990, Nepal adopted liberal economic policies and steps were taken to attract FDI accordingly. Furthermore, Nepal was ranked 124th among 136 countries in Global Opportunity Index Ranking, 2015 with a score of 3.43. But according to Global Competitiveness Index 2017-18 (edition) published by World Economic Forum, Nepal scored 4.00 points and ranked 88th among 137 countries. This shows that we have yet to perform a lot for increasing FDI in our economy, though there have been some positive changes in the economy in recent years.

Present Status and Regulatory Framework

A total of 3905 industries from 90 different countries have been registered securing approval of NPR 208.04 billion FDI in FY 2016/17. However, Nepal received only NPR 10.15 billion foreign investment in industries in the first eight months of the period. India has the largest share of 39.08 percent in the sum followed by China, Hong Kong, South Korea and British Iceland in the top 5 FDI receiving countries (Annex 1).

According to World Investment Report 2016, Nepal received USD 106 Million in FDI. Moreover, India was the largest recipient in South Asia with a receipt of USD 4,448 Million. Nepal was ranked 6th in the region with a share of 1.03%. Only Afghanistan and Bhutan remain behind Nepal. In Starting a Business index ranked Nepal 109th, compared to Afghanistan (42nd), Bhutan (94th), India (155th), Pakistan (141st), and Sri Lanka (74h) (Doing Business, 2017 – Annex 4). Studies show that good regulatory regime is needed for domestic firms to imply higher FDIs.

The constitution of Nepal directs the state policy to encourage and mobilize foreign capital and technology investment for import substitution, export promotion and infrastructure development to suit its national interests (Article 51 D 10). The ongoing 14th periodic plan has envisioned an innovative, competitive and dynamic economy thorough the mobilization of foreign investment. Foreign Investment Policy, 2014 has set the goal of making national economy competitive and

dynamic by maintaining trade balance through import substitution and export promotion attracting foreign capital, technology, skill and knowledge in national priority sectors.

Nepal has realized the high importance of foreign investment in economy and taken steps to attract FDI. Regarding FDI, there are several rules and regulations which currently prevail in Nepal. Foreign Investment and Technology Transfers Act, 1992; Industrial Enterprises Act, 2016; Private Investments in Infrastructure Act, 2006; Investment Board Act, 2011; Contract Act, 2000; Company Act, 2006; Income Tax Act, 2002; Foreign Exchange (Regulation) Act, 1963 are examples. Many of these laws need to be updated in the present context. Foreign Investment and Technology Transfer Act (FITTA), Foreign Exchange Regulation Act (FERA), Labor/Immigration Act are important for establishing a firm under FDI. Further, various acts concerned with operation of the forms are Industrial Enterprise Act, Electricity Act, Environment Protection Act, Land Acquisition Act, Labor Act, Water Resources Act, Telecommunications Act, Income Tax Act, VAT Act, Excise Duty Act, Bonus Act, Patent Design and Trademark Act, Competition Promotion and Market Protection Act, Consumer Protection Act, Copyright Act, Banks and Financial Institutions Act. This outlines legal complexity in FDI.

Multiple agencies are involved in the approval of FDI. Department of Industry (< \$20 mn); Industrial and Investment Promotion Board (\$20 mn - \$100 mn); Investment Board of Nepal (>\$100 mn) are three main agencies involved in FDI depending upon investment volume. Office of Company Registrar (OCR), Sector Agencies (e.g. Telecom, Airline, and Mining), Department of Inland Revenue, Central Bank, and Department of Immigration are also involved in this process.

Various programs are proposed in 14th plan (launched in FY 2073-74) for attracting and mobilizing foreign investment last year. Formulation of new act; Provisions of monetary and non-monetary incentives; and Agreements on Bilateral Investment Promotion and Protection and Dual Taxation Exemption are some policy measures for attracting FDI. Development and expansion of physical infrastructures, including access to roads and electricity transmission lines; Ensuring industrial security and energy; Improved service delivery on registration and land acquisition processes for industries established with foreign investment are other measures for attraction. Reforming legal and procedural provisions as well as institutional improvement; Setting up a project bank in prioritized sectors of foreign investment are proposed for FDI mobilization. Furthermore, mobilizing foreign investment in producing goods and services related to trade with neighboring countries and optimum utilization of local resources and skills are other programs.

Challenges and Opportunities

Though Foreign Direct Investment is prioritized in government policy, the FDI inflow in Nepalese economy is still not satisfactory. There may be various reasons due to which foreign investors seem to not be interested in investing here The Global Opportunity Index has identified

four factors of opportunity: Economic Fundamentals, Ease of Doing Business, Quality of Regulations and Rule of Law. Betterment of these factors are mainly responsible for attracting FDI. Political instability and transition is responsible for low economic development. Due to frequent changes in government, Nepal has become unable to pay key attention in attracting FDI. Political instability leads to policy uncertainty, hence foreign investors hardly gets ensured. Furthermore, the nation is in the phase of adopting federal structure. Since, all the structures and institutions have not been established yet, therefore the investors may be in ambiguity.

Lack of skilled labor force and technological expertise, regulatory barriers, inadequate physical infrastructures, repatriation concerns, exchange rate variability etc. are other concerns of investors and challenges of FDI inflow. The investors are aware about national credit rating of a nation for investing but Nepal is not rated till now.

There are ample opportunities in Nepal for FDI: the abundant natural resources, cultural and biological diversities, economically strategic location between two giant economies China and India, comparative low wages are some examples. Since the economy is underdeveloped there are various unutilized sectors, so foreign investors can be benefited from the situation. Various incentives have been provided to foreign investors by the government which is an opportunity for foreign investors.

Way Forward

There is enough space in Nepali economy to accommodate FDI where the economy and investors can be mutually benefited. So it is necessary to attract more FDI in the economy. We have to update our policy and make reforms in it. Furthermore, the implementation of rule of law and promoting good governance is also necessary.

Rigorous consultation should be performed with private sectors for generating reform agendas. A platform like Nepal Business Forum for public private dialogue can play significant role. Steps towards maintaining good industrial relations are essential. As well as, Labor flexibility and welfare protection should go hand in hand. For these, the existing Labor Act needs amendment and legal measures for workers' social safety should be added. Various schemes offered through legislations are good, however, robust and timely evaluation is necessary for the desired impact.

We need to explore the country's Economic Fundamentals (EF) (macro-performance, trade openness, quality and structure of the labor force, and modern infrastructure), Financial Services (FS) (financial infrastructure and the business community's accessibility to credit), Business Perception (BP) (the size of tax burdens, corporate transparency, corruption, etc.), Institutional Framework (IF) (institutions provide a supportive business environment) and International Standards and Policy (ISP) (institutions, policies, and legal system facilitate international integration by following international standards) to make policies and a business environment that is conducive .

Annex 1 : Foreign Investment on Industries in Last Ten Years

Fiscal Year	No. of Registered Industries	Total Capital (in Rs. Million)	Fixed Capital (in Rs. Million)	Total Foreign Investment (in Rs. Million)	Employment
2063/64	188	3426	2651	3186	7389
2064/65	213	20406	16898	9813	10709
2065/66	231	9418	7530	6255	11108
2066/67	171	13954	14988	9100	7848
2067/68	210	11253	9377	10053	10902
2068/69	226	11910	10736	7138	9035
2069/70	317	51991	41046	19819	16569
2070/71	307	40737	35049	20133	11790
2071/72	370	81370	77437	67455	13167
2072/73	347	20499	14123	15232	11649
2073/74*	213	11519	8176	10151	6377
Total	2793	276483	238011	178335	116543

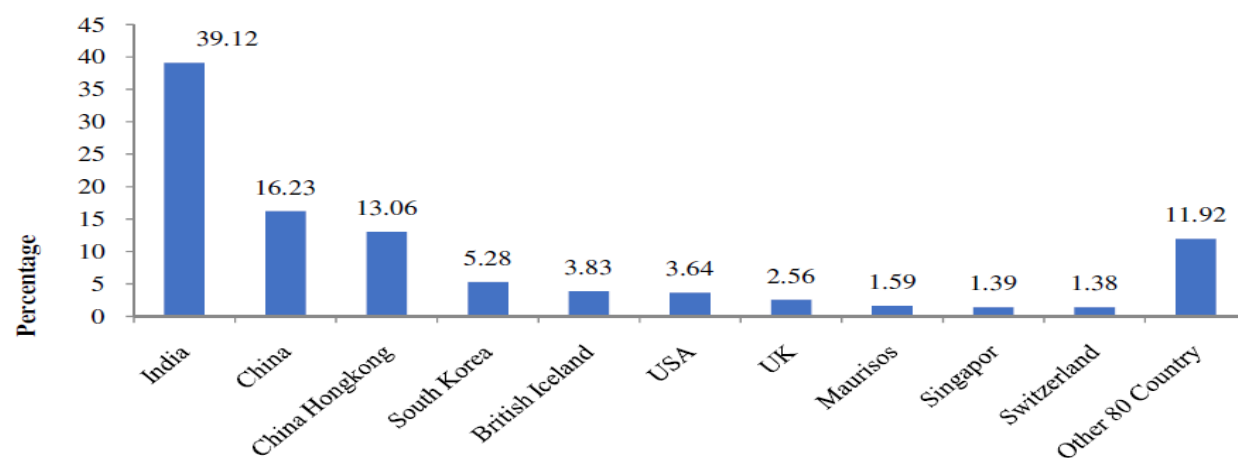
Source: Department of Industry *Until first eight months

Annex 2: Foreign Investment by Country

S.No.	Country	No. of Industries	Foreign Investment (In Rs. Million)	Cost Based Percent	Employment
1	India	662	81312	39.12	66027
2	China	1093	33768	16.23	51324
3	Hong Kong China	33	27188	13.06	4651
4	South Korea	312	10999	5.28	10593
5	British Iceland	14	7967	3.83	2054
6	USA	344	7581	3.64	16869
7	UK	160	5330	2.56	10549
8	Mauritius	9	3315	1.59	952
9	Singapore	38	2896	1.39	3035
10	Switzerland	55	2891	1.38	1475
	Other 80 Countries	1185	24796	11.92	56757
	Total 90 Countries	3905	208043	100	224286

Source: Department of Industry

Annex 3: Share of Foreign Investment by Country



Source: Department of Industry

Annex 3: Nepal's Position in Doing Business among SAARC Nations

S.No.	Country	Position/Rank among 190 Countries	Score
1	Bhutan	73	65.37
2	Nepal	107	58.88
3	Sri Lanka	110	58.79
4	India	130	55.27
5	Maldives	135	53.94
6	Pakistan	144	51.77
7	Bangladesh	176	40.84
8	Afghanistan	183	38.10

Source : Doing Business, 2017