

Policies and Procedures Relating to Foreign Private Capital in Nepal

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Introduction

Foreign private capital is not a new phenomenon in the Nepalese economic scene. During the period of isolation (1946-1950), when economic activities in Nepal were based primarily on the self sufficient household economy, which used to provide most of necessities of Nepalese people, due to low level of demand of the household sector, the demand for manufactured products was at low level and consequently, foreign trade did not play any substantial role. British companies with a huge turnover of business in British-India, did not have so much trade with Nepal, and very few westerners were allowed to come to Nepal. The economic philosophy of the ruling family of Rana was not to allow the Nepalese mass to have conspicuous consumption, so the market for manufactured products was very limited, which did not encourage the establishment of industries and for the improvement of agricultural sector. The foreign private capital was not interested in establishing industries in Nepal because of the limited markets for the industrial products. However, in the trade sector foreign private capital had played an important role. In both the import and export trade Indian businessmen played an important part. In most of the urban and administrative centres Indian Businessmen had their shops for selling imported products. In the exports of forest and agricultural products the Indian contractors and merchants were involved heavily. With the political change of 1951, the pattern of foreign private capital in Nepal remained as such till the announcement of policy in the year 1961 which invited the participation of foreign capital in certain size of industries. However, private capital participation did not flow into Nepalese industries. In the subsequent amendments of the industrial policy too, the flow of private foreign capital was expected. The Industrial Policy of 1981 has prominently highlighted the role and importance of foreign investment and has provided various policy support to it. In fact the Industrial Policy of 1981 can be regarded as the beginning of institutional efforts towards the mobilisation of private investment in the industrial development of Nepal.

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In fact this is the document which has touched upon the issues on foreign investment.

Policies and Efforts to Mobilise Foreign Private Capital in Nepal

In order to encourage investment from foreign investors the Industrial Policy of 1981¹ has given due consideration by spelling out the following elements:

Objectives of Obtaining Foreign Investment

The policy has clearly emphasised that foreign investment in industrial enterprises will be encouraged for (i) access to desirable technology, (ii) expansion of export markets, (iii) acquisition of higher management standards, (d) increase in employment opportunities, (iv) promotion of capital inflow and (v) improvement in productivity.

Nature and Form of Foreign Investment

An industrial enterprises financed by foreign investment must be incorporated as a limited liability company in Nepal. The investor may be a government, firm, individual company or an international institution. Foreign investment is limited to medium and large industrial enterprises.² Foreign investment is allowed up to majority holding in the medium and one hundred percent in the large industrial enterprises.

Concessions

(i) Industrial enterprises with equity participation will not be nationalised except in special circumstances, in which case, compensation will be paid to investors on the basis of a just valuation of the networth of the enterprises. (ii) If an industrial enterprise, having foreign investment, goes into liquidation, a foreign investor can repatriate his share of proceeds of sales of assets in convertible currency under the Nepal Company Act. No taxes will be levied on such amounts. (iii) His Majesty's Government of Nepal or its designation agency will stand guarantee on the long term loans under prescribed terms and condition, (iv) Provision will be made through institutionalised procedures to facilitate a simple, smooth and integrated approach to foreign investment, joint ventures and arrangements for the guarantee of long term loans.

Remittances of Capital and Repatiration of Profits

(i) If a foreign investors makes an equity investment in a Nepalese industrial enterprises, in convertible foreign currency, one hundred percent of the dividend may be remitted in convertible currency, whether the enterprise is jointly or severally owned (iii) If a foreign investors invests in shares in terms of convertible currency foreign currency, such shares may be sold only after an enterprise has commenced operation. Repatriation of capital will be at the rate of 20 percent of the sales proceeds of the shares

each upto the limit of the total investment made in convertible currency (iii) if a foreign investor has invested in a Nepalese Public Limited Company and has sold shares through the Nepalese Security Marketing Centre, the sales proceeds may be remitted in convertible currency at the maximum annual rate of 25 percent of the original total investment made in convertible currency. (iv) Managerial and technical experts who have been engaged, with prior approval of HMG and who belong to countries where convertible currency is freely exchanged can remit in convertible currency, up to 75 percent of earnings generated by way of salary and allowances.

Procedures Relating to Foreign Investment in Industries

Foreign investment in Industrial Enterprises in Nepal is governed by the Foreign Investment and Technology Act, 1981³ and the major provisions under this act have briefly indicated below.

Enterprises such as manufacturing industry, energy based industry, agro-based special industry, mining and mineral processing industry, tourism industry, service industry recreation industry, assembly industry, promoted by an individual, firm, company, cooperative or a corporation have been defined as industry.

The Foreign Investment and Technology Act 1981 has spelled out the procedures relating to the foreign investment in industries. According to the act "any foreign investor or the national investor desirous of establishing any joint venture industry shall have to file an application in the prescribed form to the Department to obtain the permission of such joint venture." The applicant while submitting the application, should have a feasibility study of the proposed enterprise. Then the proposal is studied by the Industrial Promotion Committee formed according to Industrial Enterprise Act, 1981, on the basis of five elements, viz. (i) appropriateness of the industry, (ii) nature of industry-import substituting or export promoting type, (iii) potentiality for using local raw materials, (iv) availability of employment, management and technical training to Nepalese, (v) terms and conditions of foreign investment, loan and transfer of technology. Basing on the recommendation, the Department of Industry will permit the foreign investor to set up industry in Nepal. However industrial enterprises are required to have prior approval of the Department before (i) obtaining foreign loan, (ii) increasing the proportion of the foreign investment, (iii) entering into the agreement for the transfer of technology and (iv) diversifying production, capacity expansion and modernization.

The Foreign Investment and Technology Act 1981 has made provisions for liberal and attractive facilities and incentives for foreign investment in Nepal. The facilities and incentives include provisions for capital repatriation, taxes and tariff concessions, convertible exchange facilities, depreciation facilities and other facilities, related to various aspects of investment.

Other Efforts⁴

HMG/N with an objective to provide institutional support to the process of mobilisation of foreign private capital, has established a wing on Foreign Investment under the Ministry of Industry, which is helping to find out foreign partners in the industrial development of Nepal. In addition, this wing has been maintaining a link with UNIDO, which has been helping to find out foreign partners. The Ministry of Industry, with an objective to invite foreign investors, has been carrying promotional activities, thereby organising meetings, seminars and participating in various industrial fairs and exhibitions. The domestic or national private capital has also been engaging themselves to seek for foreign investors. It is due to their efforts certain foreign investors have already been involved in some industries.

Problems and Difficulties Relating to Foreign Private Capital

The role of foreign private capital has been envisaged in the industrial sector only. However, it is existing in trade, construction and service sectors also. It is being felt that enormous amount of Indian private capital is being invested in the trade construction and service sectors of Nepal, through direct capital participation, but, there is no governmental policy and procedure to monitor such investment. Because of lack of such procedure, the actual quantum of foreign capital participation in such sectors is not known to the government. This has caused difficulties in channelising such investment in the desired areas.

Foreign private capital is attracted generally to such investments which have export potentiality where the rate of profit is high, and where from repatriation can be made easily. Seeing the economic setting of Nepal, except trade sector and the construction sector (especially the construction of bigger projects from multilateral aid), industries have been established for catering the domestic needs of the people so such industries have not attracted so much foreign private capital.

The office for the promotion of foreign investment has been established very recently, and it has not yet been able to attract foreign private capital in industries due to (i) lesser promotional drive due to lack of fund, (ii) lesser communication with the developed market economies where from foreign private capital flows, (iii) weak organised private sector having lesser contact with potential foreign investors.

The Foreign Investment Promotion Office has neither collected any information on the flow of foreign capital nor has carried any research work pertaining to foreign private investment. Information on foreign private industrial enterprises, which have been registered with the Department of Industry, is not published even by the Department of Industry. Consequently the magnitude of foreign private investment in industries is also not known to us. Any observation and comments in this area becomes purely a guesswork.

In spite of the announcement of policy for promoting foreign private investment by

giving various sorts of concessions and facilities, the foreign private capital has not show deep interest to invest in Nepal. The reasons for this has not been thoroughly studied by the concerned department of HMG of Nepal.

In order to attract foreign private capital, there is the need for the development of specific infrastructure in the domestic front. The Industrial Policy has clearly stated that the industrial enterprises financed by foreign investment must be incorporated as a limited liability company in Nepal, this demands for the development of the culture of corporate sector in the domestic front. However, there is the tendency among the Nepalese investors to form private company rather than limited liability company. This dichotomy has not created a congenial environment to attract foreign investment.

The Foreign Investment and Technology Act 1981 has treated foreign investment in general, whether it is from more developed or less developed countries. In a small least developed country like Nepal, with small resources base and small size of the domestic market, big multinationals may not be attracted so much, there is more possibilities of the flow of foreign investment from countries of South and South East Asia. The Act does not provide some preferential treatment to attract investment from the region.

The concessions and facilities provided to foreign investment in Nepal under the Foreign Investment and Technology Act 1981 seem more than what they used to be in the past, but it has not yet been analysed whether such concessions and facilities are more or less as provided by other countries of South and South East Asia. If our facilities and concessions are more than in other countries of this region then only foreign investments are attracted. We have not yet done a comparative study on the concessions and facilities provided by the countries of South and South East Asia for attracting foreign investment.

It is generally said by the private investors that a long procedure with series of formalities is required to initiate a corporate business here, which has not created a congenial environment for the attraction of foreign investment. Generally the direct investments by the foreign investor are made more on the basis of the long term outlook than on the basis of tax incentives.⁵

Areas where Attention to be Given

Foreign investment is important and helpful to the initiation of various economic activities in Nepal, where domestic source of capital and indigenous technique is not sufficient to accelerate the rate of economic growth. However, it does not mean that it should be allowed to come in any activities of the Nepalese economy. A trade-off between the positive and negative aspects of foreign private capital is to be identified in order to get benefit from it. In order to achieve this, the author feels that the following factors should get due attention of the government.

In order to invite foreign private capital, the first prerequisite is to create a well-

developed corporate sector within the country, so that the foreign investors in the form of multi-national or bi-national will get appropriate counterparts on whom they can rely on. This should be the immediate efforts of the government.

The Foreign Investment Promotion Wing should be strengthened to keep the records of all the foreign investment on their nature, size and activities, so that a complete profile of foreign investors could be prepared; to study the possibilities of inviting new participants; to carry out study on the problems faced by the foreign investors, and to study the effectiveness of the concessions and facilities provided by the government to foreign investors.

Promotional activities for encouraging foreign investment should be carried through Nepalese missions in developed and less developed market economies, not only organising seminars and symposiums but the firms of such countries are to be contacted personally and the matter is to be discussed on firm to firm basis. This may help to understand our situation and motivation for investment in Nepal can be developed. Whenever the foreign investors will carry their feasibility mission, after their orientation from our mission offices, the Foreign Investment Promotion Wing must be able to provide all sorts of information regarding the proposed areas for investment.

The Nepalese private investors are to be encouraged to build up contact with the foreign investors, by providing them information on the investors in the market economies of more developed countries and that of the countries of South and South East Asia. This would help to institutionalise the workings of the Nepalese investors.

The flow of foreign investment should not be limited only to the industrial sector but it should be mobilised to such sectors as agriculture, trade and mining, so that these sectors can also rationalise their operations.

In the last it is imperative to mention that the mobilisation of foreign private capital participation in a country like Nepal, is not an easy task as we apparently feel, it needs to have an institutional approach with a full socio-political and economic backing of the nation. The task is to be handled by very efficient managerial cadre, for their task is to find out an understanding between a tradition bound society of Nepal with the very modern corporate sector of the developed economies, developed in a different institutional framework.

Foot Notes and References

1. Ministry of Industry and Commerce, HMG/Nepal, *Industrial Policy 2037*, (Kathmandu : Department of Industry, 1981).
2. Industries have been classified on the basis of fixed asset investment into four categories: Large Industry (fixed investment exceeding Rs. 10 million); Medium Industry (fixed asset investment between Rs. 2 million to Rs. 10 million); Small Industry (investment in machinery and equipments is from Rs. 200

thousand to Rs. 2 million in value), and Cottage Industry (investment in machinery and tools does not exceed Rs. 200 thousand).

3. Department of Industry, HMG/Nepal, *Foreign Investment and Technology Act*, 2038 (Kathmandu: Ministry of Law and Justice, Law Books Management Committee, 1981).
4. Industrial Services Centre, *Investors' Guide to Nepal*, 2nd ed. (Kathmandu: ISC, 1982).
5. ILO, *Sharing in Development- a programme of employment, equity and growth for the Philippines* (Geneva: ILO, 1974).