

Foreign Direct Investment Trend in Nepal and Recent Changes in Bylaws to Reduce Administrative Hurdles.

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ABSTRACT

Foreign Direct Investment is one of the major source of external finance for the economic growth and development of a country, specially the Least Developed Countries (LDC's) like Nepal. Inflow of FDI is very low in Nepal in comparison to its neighboring countries. In this paper comparative analysis of FDI inflow in Nepal and in SAARC countries and administrative hurdles in importing FDI in Nepal has been analyzed to come to the conclusion.

This study is based on the secondary data of FDI inflow in recent five years, acts, rules, regulations, and bylaws regarding FDI and their recent improvements. In the past, investment climate in Nepal was not favorable to the foreign investors and FDI inflow was very low. Amendment and change in laws and regulation to simplify administrative procedures has created good investment climate in Nepal and being favorable to foreign investors. We can expect that FDI will increase remarkably in the days to come.

Key Words: FDI, FDI inflow, Administrative, Investment climate, Procedure

INTRODUCTION

An investment made by a company or individual in one country into business interests located in another country is considered as Foreign Direct Investment (FDI). Foreign direct investment (FDI) can be an important external source of financing where domestic investment is limited for the economic growth and development of the country. Basically the Least Developed Countries (LDCs) are seeking for FDI to support their economic growth and development. FDI is not only the source of fund; it is also associated with transfer of technology, administrative and organizational skills also. Favorable policy, attractive projects, access to the market, availability of raw materials at cheap price, cheap manpower, lower tax rate etc. of the host country attracts the foreign investors to invest in such country.

(Organization for Economic Cooperation and Development (OECD), 2008),

FDI is a category of cross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest (10 percent or more of voting stock) in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor. The main accounts for presenting FDI statistics are FDI positions (FDI Stock), FDI Financial transactions and FDI Income.

In the context of Nepal, Nepal's Nepal Rastra Bank Foreign Investment and Foreign Debt Management Regulation- 2078 (2021), has identified following investment as Foreign investment:

- i. Share investment in Foreign currency
- ii. Re-investment of dividends from prior investment
- iii. Lease investment in aircraft, ship, machinery and equipment, construction apparatus or similar equipment
- iv. Investment made by establishing venture capital fund
- v. Investment made in listed securities through secondary market.
- vi. Investment made by acquiring shares or assets of a company incorporated in Nepal
- vii. Investment received through bank after issuing securities in Foreign capital market by a Nepalese entity.
- viii. Investment made through technology transfer
- ix. Investment made by establishing and expanding its branch in Nepal.

II. OBJECTIVE OF THE STUDY

The objectives of this paper is to analyze the trend of FDI inflow in Nepal in comparison to its neighboring countries in the SAARC and analysis of the latest improvements in laws, bylaws and regulations to promote FDI inflow in Nepal.

III. METHODOLOGY USED

The researcher adopted qualitative strand using desk-study research strategies and secondary data. Comparative analysis of data and descriptive approach has been used to achieve the objectives of this paper.

IV. TREND AND CURRENT TSATUS OF FDI IN NEPAL AND SAARC Region

In comparison to neighboring countries, FDI inflows to Nepal are low. In recent years it was started to grow but the COVID-19 Pandemic affect the

every sectors of investment, FDI also affected with this. The researcher describes trend of Net FDI inflows in SAARC Regional context and summarizes trend of Nepal's net FDI inflows.

(A Survey Report on Foreign Direct Investment in Nepal, Nepal Rastra Bank 2021). Nepal has been destination for foreign investment from 53 different economies as of mid-July 2019. In terms of total FDI stock, India stood in top position with Rs. 56.05 billion followed by China, Saint Kitts and Nevis, Ireland, and Singapore with Rs. 27.56 billion, Rs. 24.94 billion, Rs. 11.59 billion and Rs. 8.73 billion respectively.

According to UNCTAD's 2021 World Investment Report, FDI inflows of Nepal decreased by 31.89 per cent from USD 185 million in 2019 to USD 126 million in 2020. In SAARC Region FDI inflow of India increased by 26.71 per cent where as all other countries are decreased. India remained largest FDI recipient country in this Region with inflows of USD 64062 million in 2020. Out of the Total FDI inflow in SAARC Region in 2020, India covers 91.97 per cent, Bangladesh 3.68 per cent, Pakistan 3.302 percent, Sri Lanka 0.623 per cent, Maldives 0.50 percent, Nepal 0.181 percent, Afghanistan 0.018 percent and Bhutan 0.004 per cent. FDI inflows to South Asia increased by 20.91 per cent from USD 57607 million in 2019 to USD 69655 million in 2020.

According to UNCTAD's World Investment report, Global Foreign direct investment (FDI) flows fell 35% worldwide in 2020 compared to 2019 due to the COVID-19 pandemic. (UNCTAD, 2021)The impact of the pandemic on global FDI was concentrated in the first half of 2020. In the second half, cross-border M&As and international project finance deals largely recovered. But Greenfield investment – more important for developing countries – continued its negative trend throughout 2020 and into the first quarter of 2021.

According to UNCTAD's World Investment report, FDI trends varied significantly by Region. Developing Region and transition economies were relatively more affected by the impact of the pandemic on investment in GVC-intensive and resource-based activities. Asymmetries in fiscal space for the roll-out of economic support measures also drove Regional differences. In 2020 FDI flow to Europe falls by 80 per cent, Africa decreased by 16 per cent where as in China it is increased by 6 per cent. FDI flow to India is increased by 26.71 per cent in 2020 due to merger and acquisition activity.

Table 1 shows the comparative status of FDI Inflows of SAARC Nations.

Table 1: FDI Inflows of SAARC Nations (in US\$ million)

Country/ Year	2015	2016	2017	2018	2019	2020	% change 2020	% in Total 2020
Afganistan	163	94	53	119	39	13	-66.67	0.018663
Bangladesh	2235	2333	2152	3613	2874	2564	-10.79	3.680999
Bhutan	6	-34	-9	7	3	3	0.00	0.004307
India	44064	44481	39404	42156	50558	64062	26.71	91.97043
Maldives	299	457	458	576	956	348	-63.60	0.499605
Nepal	52	106	198	67	185	126	-31.89	0.180892
Pakistan	1673	2576	2496	1737	2234	2105	-5.77	3.022037
Sri Lanka	680	897	1373	1614	758	434	-42.74	0.623071

Source: UNCTAD's World Investment Report (2021)

Nepal is located between India and China and can access to the huge market of the world. She has attractive profitable investment opportunities particularly in the energy, tourism, information and communication technology (ICT), infrastructure and agriculture sectors. Inflow of FDI is very low in comparison to other neighboring countries. (U.S. Department of State, 2021 Investment Climate Statements: Nepal, 2021), Despite considerable potential – particularly in the energy, tourism, information and communication technology (ICT), infrastructure and agriculture sectors – political instability, widespread corruption, cumbersome bureaucracy, and inconsistent implementation of laws and regulations have deterred potential investment. While the Government of Nepal (GoN) publicly states its keenness to attract foreign investment, this has yet to translate into meaningful practice. The COVID pandemic further slowed reform efforts that might have made Nepal a more attractive investment destination. Despite these challenges, Foreign direct investment (FDI) into the country has been increasing in recent years. Historically, few American companies have invested in Nepal.

Up to few years ago power crisis was considered as one of the major problem for FDI, but now power crisis is almost solved. Poor Infrastructure, administrative hurdles, proper identification of investment projects etc

problems are still to be solved.

V. LIBERALIZATION IN ADMINISTRATIVE & LEGAL PROCEDURES

Nepal has recognized Foreign investment one of the most important tool to upgrade the nation as a middle-income country by 2030. Government of Nepal has given importance to the FDI. For that reason, Nepal has made mentionable improvement in business climate and administrative procedures in recent years to increase FDI inflow.

Foreign Investment and Technology Transfer Act (FITTA) is revised in 2019 to create investment friendly environment to the Foreign investors. Nepal has signed the Bilateral Investment Protection and Promotion Act (BIPPA) with six countries including India which is the highest Foreign direct investors in Nepal. Approval of FDI within Seven days of application, single window service center, decision within Fifteen days for profit repatriation process, increase in minimum foreign investment threshold of USD 41,500 to USD 415,000, national treatment to all foreign investors, foreign companies will not be nationalized etc. are the major improvements to reduce administrative hurdles. The sectors excluded from foreign investment are listed in the annex of the FITTA 2019 and include:

- i. Primary agricultural sectors including animal husbandry, fisheries, beekeeping, oil-processing (from seeds or legumes), milk-based product processing; (Note: The GoN is attempting to open this sector for FDI if 75 percent of the products are exported. However, the matter is under review at the Supreme Court.)
- ii. Small and cottage enterprises;
- iii. Personal business services (haircutting, tailoring, driving, etc.);
- iv. Arms and ammunition, bullets, gunpowder and explosives, nuclear, chemical and biological weapons, industries related to atomic energy and radioactive materials;
- v. Real estate (excluding construction industries), retail business, domestic courier services, catering services, money exchange and remittance services;
- vi. Tourism-related services – trekking, mountaineering and travel agents, tourist guides, rural tourism including arranging homestays;
- vii. Mass media (print, radio, television, and online news), feature films in national languages;

- viii. Management, accounting, engineering, legal consultancy services, language, music, and computer training; and
- ix. Any consultancy services in which Foreign investment is above 51 percent.

Parliament approved the Special Economic Zone (SEZ) Act in 2016 August, to provide special facilities for investors in SEZs. Exemptions on customs duties for raw materials, simple and easy registration processes, access to electricity facility, and prohibition of Labor strikes etc. are some attractions of the SEZ. More incentives and attractions are provided to Foreign investors after a revision to the SEZ Act in 2019. Government of Nepal is developing the country's first two special economic zones in Simara and Bhairahawa and plan to have 15 SEZs throughout the country. Recently Nepal Rastra Bank has Recently issued Foreign Investment and Foreign debt Management Regulation-2078 (2021) after collecting the suggestions from stakeholders and experts by distributing draft for this.

- "One step approval" instead of "Two step approval"
- The Foreign Investment and Foreign Debt Management Bylaw has abolished the arrangement for Foreign investors to take prior approval from the central bank to invest in Nepal.
- Work on Automatic route (work flow, Easy process)
- Once the Foreign direct investment (FDI) is approved by the concerned authority (Investment Board Nepal and Department of Industry), pre-approval from Nepal Rastra Bank (NRB) is no longer required and a written notice to NRB will be sufficient.
- Foreign purchases of shares in the stock market are still subject to pre-approval from the NRB.
- Procurement of foreign loans will also require NRB's approval, which will be provided within 15 days and the obtained loans to be reported within six months.
- Authorized interest rate on Foreign loans is up to an additional 5.5% on the annual London Interbank Offer Rate (LIBOR).
- Provision to obtain up to USD one million and INR 100 million worth of loans is available.
- Currency exchange for the repayment of foreign loans can be executed by Banks and Financial Institutions (BFIs) without the approval from NRB.
- Quarterly updates of incoming and outgoing foreign currency must be

reported to concerned BFIs within the 15-day period from the end of each quarter.

- More ease in withdrawing FDI profit out of the country.
- Reduction in administrative hurdles

Table II: Comparison with South Asian countries For the Protection of Investors

	Nepal	South Asia
Index of Transaction Transparency*	6.0	5.0
Index of Manager's Responsibility**	1.0	5.0
Index of Shareholders' Power***	9.0	6.0

Source: World Bank, Doing Business Report 2020

Note: *The Greater the Index, the More Transparent the Conditions of Transactions. **The Greater the Index, the More the Manager is Personally Responsible. *** The Greater the Index, the Easier it Will Be For Shareholders to Take Legal Action. **** The Greater the Index, the Higher the Level of Investor Protection.

Table II depicts that the conditions of investor's protection in Nepal is better than that of average index of South Asia. Manager's responsibility is very low in comparison to average index in South Asia, where as shareholders power in Nepal is higher than that of South Asia. In aggregate, the condition of investor's protection is good in comparison to South Asia.

Table III: Comparison with South Asian countries For the Business setup procedure

Setting up a Company	Nepal	South Asia
Numbers of procedures	7.00	8.10
Days for procedure	16.50	15.40

Source: World Bank, Doing Business Report 2020

Table III shows that, in Comparison to South Asia average, the number of procedures to setup business in Nepal is low but days for procedure is little bit high. In aggregate business setup procedure is also similar to South Asia and now it is easy to setup business in Nepal by foreigners also.

VI. CONCLUSION

Investment climate in Nepal was not so favorable in the past. Political instability, unclear policy, administrative hurdles, twelve years long armed political war, power crisis, poor infrastructure, etc. were the major causes of not receiving FDI as expected. But In recent years, investment climate in Nepal has been improved. Power crisis has been almost finished, political environment is also not bad for investment even there is some political instability. All most all political actors are in favor of FDI. Various acts, rules and regulations regarding FDI have been improved. World Bank's doing business report shows that protection of investors and business setup procedure in Nepal is good among South Asian countries. Amendment in Labor act in 2017, provision of SEZ, revision in FITTA, Recently issued Foreign Investment and Foreign debt Management Regulation-2078 (2021), simplification in business establishment procedures, high rate of return on investment, less costly resources and manpower, huge market in neighboring countries may attract Foreign investors in Nepal and inflow of Foreign Direct Investment in Nepal will increase remarkably in the days to come.

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