Foreign Direct Investment in Nepal

Current status, prospects and challenges

Ratnakar Adhikari

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I. Introduction

For a least developed-country (LDC) like Nepal with huge saving-investment gap; limited, albeit growing, revenue to gross domestic product (GDP) ratio; and limited amount of foreign aid flow, foreign direct investment (FDI) is considered an indispensible mode of development financing. Although FDI is traditionally viewed as foreign investments made in manufacturing and services sectors, which undoubtedly contribute to employment opportunities as well as economic growth, they are increasingly attracted by host countries for meeting financing requirements for large infrastructure projects. This is an area in which foreign investors used to shy away from investing in the past due to various risks associated with such projects resulting from long gestation and pay back periods. In the context of Nepal, although FDI is generally welcome in all sectors, due to acute dearth of resources for infrastructure financing, it has become an imperative in the latter sector. It must be noted that the utility of foreign investment for a country like Nepal does not end there. It is an instrument for the transfer of technology from the technology-rich countries to technology-deficient countries. Similarly, leadership and managerial skills transferred by foreign investors and eventual expansion of local knowledge and skill base, whether at the enterprise level or at the sectoral level, are considered yet another spillover impact of foreign investment.

The growing salience of FDI is aptly captured by the World Investment Report 2012 produced by the United Nations Conference on Trade and Development (UNCTAD), a reading of which suggests that it is not only the traditional North-South flow of foreign investment that is significant, but new and emerging sources of FDIs should also be taken into account while targeting FDIs. These are: i) outward FDI flows from developing countries, which, despite a slight reduction in 2011, accounted for 23 percent of the total FDI flows; and ii) sovereign wealth funds (SWFs), which accounted for 8 percent of total FDI flows the same year.[2] Although these sources account for barely one-third of total FDI inflows, their heightened significance is manifest in the future growth potential they promise. Reliance on these sources of FDI may continue to grow in the future because of the volatility of FDI flows from traditional sources. The limit to what these sources can offer has been cruelly exposed in the recent past due to multiple crises (such as the financial crisis of 2008–2009, and the ongoing debt crisis, particularly in the Euro zone economies, which have had ripple effects in other developed countries as well) facing these economies in the recent past.

As far as inflows of FDI to South Asia is concerned, after a slide in 2009–2010, they have made a turn-around and have now reached US$39 billion. This is mainly as a result of rising inflows in India, which accounted for more than four fifths of the region's FDI.[3] The inflow of FDI, therefore, is not evenly distributed within the region, with Nepal receiving the lowest. Notwithstanding the chequered record of Nepal in terms of attracting foreign investment—particularly during the period of armed insurgency—it has made some dent in recovering its lost glory in the recent past. Although the growth rates of FDI in the recent past are reasonably good, there is little reason for complacency. First, the growth rates have been from a very low base and hence seemingly higher growth rates in percentage terms do not really translate into satisfactory levels of investment in absolute terms. Second, there is a tremendous untapped potential for attracting foreign investment in Nepal, which can be achieved through serious and concerted efforts on the part of Nepalese stakeholders. Against this backdrop, the objective of this paper is to identify opportunities and challenges for leveraging foreign investment for development in Nepal and offer some recommendations in that direction.

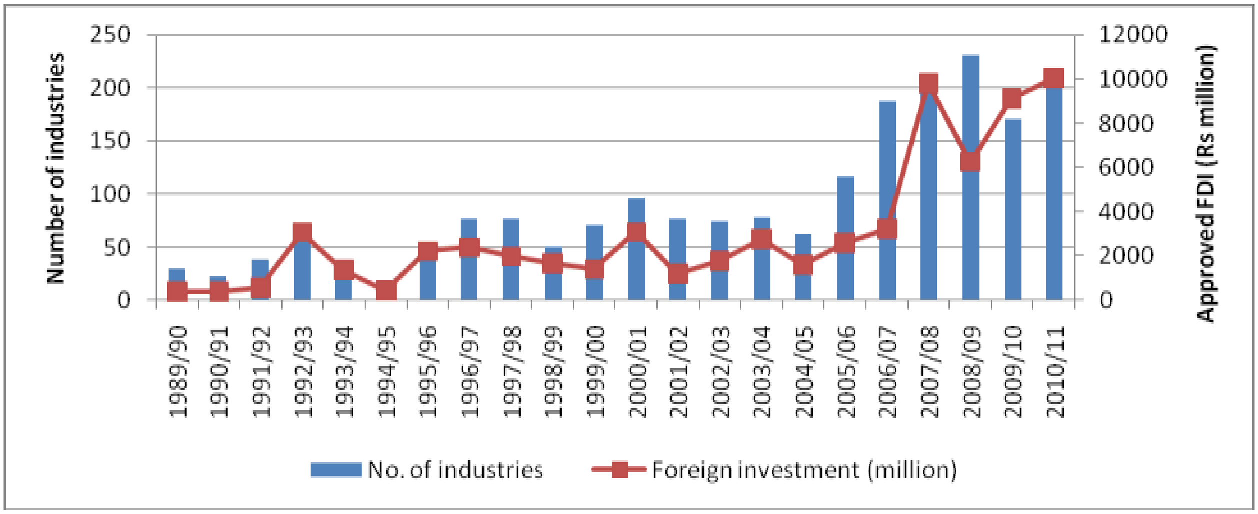
The paper is organized as follows. Section II discusses the current status of FDI in Nepal, including trends and development implications. Section III discusses opportunities and challenges for utilizing FDI to meet the county's development objectives such as poverty alleviation and inclusive economic growth. Section IV concludes the paper with some policy recommendations.

II. Current status

According to World Investment Report 2012, FDI suffered a setback in the recent past due to global financial crisis, followed by the ongoing debt crisis. The report reveals that although global FDI flows exceeded the pre-crisis average in 2011, reaching US$1.5 trillion, they still remained some 23 percent below their 2007 peak.[4] Buoyed by the growth in FDI inflow into the largest economy of the region (India), South Asia witnessed a robust growth of 23 percent in 2011 compared to the previous year. However, Nepal remains one of the worst performers in the region despite robust growth of 125 percent attained in 2011 according to the UNCTAD data.[5] In terms of the FDI potential index, Nepal ranks the lowest in the region, i.e., 175 out of 182 countries ranked globally.

On the contrary, if we look at the country-level data for FDI approval as provided in Figure 1, the picture does not look that bleak, in particular from 2006/07 onwards, which coincided with the end of the armed conflict. Although there was some reduction in FDI approval in 2008/09, which is ascribed, at least in part, to global financial crisis, the approval picked up pace in 2009/10, despite the fact that the number of industries registered went down in 2009/10.

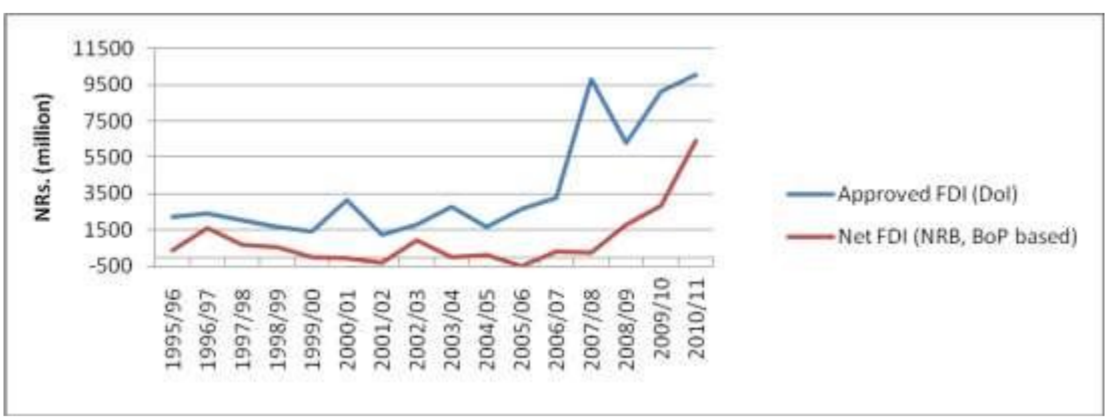
Figure 1: FDI in Nepal (No. of industries and approved amount) (1989/90 – 2010/11)



Source: Author's calculations based on DOI (2011).[6]

However, the above figure does not provide data for actual receipt of FDI, which is hard to come by in the context of Nepal. This is because the Department of Industry (DOI) does not have necessary resources and expertise to follow up with the foreign investors to see whether the committed investment, employment and technology transfer has been achieved in reality or not.[7] Therefore, we extract the net FDI figures from the Balance of Payment (BoP) data prepared by the Nepal Rastra Bank (NRB)—the Central Bank of Nepal. Although such figures are available only since 1995/96, it shows that the FDI receipt tends to follow the trend of FDI approval, with a wide variation between the two (Figure 2). Unsurprisingly, these figures are closer to the FDI inflow figures prepared by UNCTAD, which is provided in Figure 3 below.

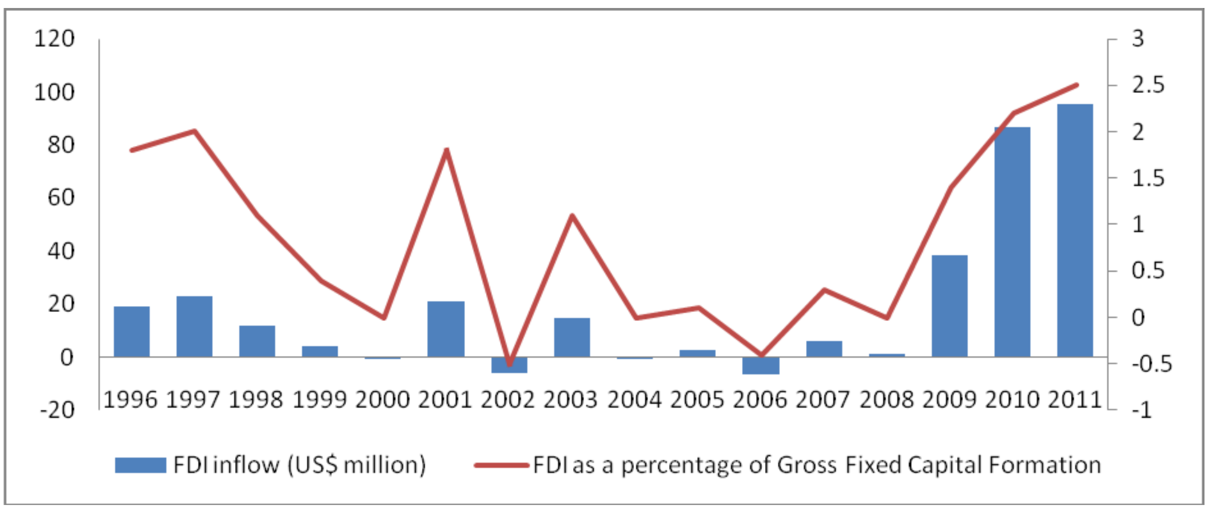
Figure 2: Approved and realized FDI (1995/96 – 2010/11)



Source: Author's calculations based on DOI (2011), Note 6 and NRB (various issues).

For a country with a low capital base, the contribution of FDI in terms of gross fixed capital formation (GFCF) is seen as an indicator to judge the development implication of FDI. For this, we refer to the figures compiled by UNCTAD, which is the only reliable source for such data. Although data is available from 1990 onwards, we have taken 1996 as the cut-off point because of several missing figures between 1990 and 1996. Figure 3 shows the FDI (actual) inflow into Nepal as compiled by UNCTAD on the left hand vertical axis and FDI as a percentage of GFCF in the right hand vertical axis. According to the figure, GFCF follows the similar pattern as FDI inflow with the recent surge in FDI pushing the GFCF to 2.5 percent, which is the highest ever recorded, although this figure is much lower than other neighbouring countries in South Asia. In 2011, while Maldives, which can be considered an outlier, received FDI equivalent to 72.4 percent of its GFCF, other South Asian neighbours, namely India (6.4 percent), Pakistan (5.3 percent) and Bangladesh (4 percent) fared much better compared to Nepal. Only three countries in the region, namely Sri Lanka (2.1 percent), Bhutan (2.1 percent) and Afghanistan (2 percent) had their FDI as percentage of GFCF lower than that of Nepal.

Figure 3: FDI inflow and FDI as percentage of gross fixed capital formation, 1996-2011



Source: Calculated from UNCTAD (2012), Note 2.

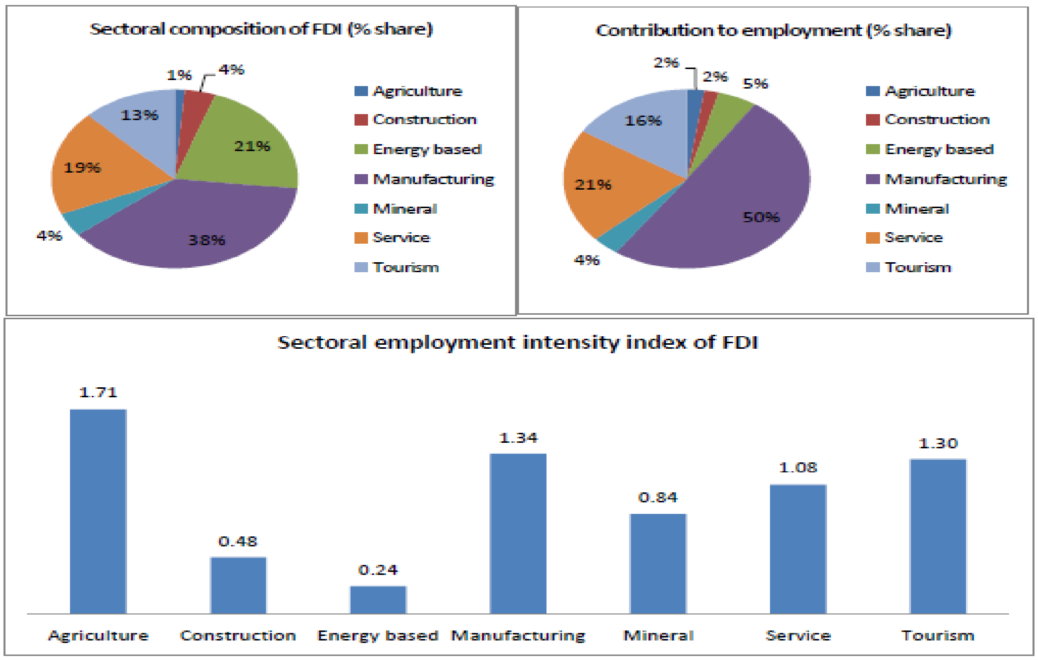
However, we suspect that some of the major investments have gone unreported not only in the DOI data but also in the NRB data. If that is true, this is an anomaly that needs to be addressed. For example, during our discussion with the Programme Coordinator of the Embassy of Finland in Kathmandu, he mentioned that TeliaSonera—a Finnish-Swedish public sector joint venture—has invested between US$200 million and US$300 million in the past couple of years for the acquisition of 51 percent stake in erstwhile Spice Nepal which has now been converted to Ncell.[8] This investment does not figure in the DOI because the approved investment in transport and communication sectors upto 2010/11 was NRs. 187 million (approximately US$ 2.7 million at the then prevailing exchange rate) and the combined investment of Finland and Sweden was a meager

NRs. 39 million (approximately US$558,000). As for the BoP data prepared by the Central Bank, there is no way to verify the sector-wise, country-wise or company-wise figures of FDI.

Sector-wise FDI approval data suggests that manufacturing is the sector with the highest investment (38 percent), followed by energy-based (21 percent) and services (19 percent) sectors, while FDI approved for the agriculture sector is the lowest (1 percent) (Figure 4, upper left panel). Although it is not always necessary for the FDI to follow the pattern of contribution of various sectors to the GDP, it appears that manufacturing sector, which now accounts for 7 percent of the GDP in Nepal, has attracted disproportionate share of FDI, and the agriculture sector, which accounts for 35 percent of the GDP, has attracted a meager 1 percent of the total FDI inflows. On the face of it, the contribution of FDI (approved) to employment in these sectors varies considerably. As shown in Figure 4 (upper right panel), employment is the highest in the manufacturing sector (50 percent) followed by services (21 percent) and tourism (14 percent), whereas the contribution of agriculture and construction sectors are the lowest (2 percent each).

We then calculate what we call "employment intensity index of FDI" by simply dividing percentage of employment (proposed to be) generated by FDI by the total amount of (approved) FDI. The result show that, FDI in the agriculture sector tends to have the highest employment intensity (1.71), followed by manufacturing (1.34) and services (1.3), whereas energy-based and construction sectors with indices of 0.24 and 0.48 have the lowest and the second-lowest employment intensity respectively.[9] This shows that per dollar of FDI in agriculture is worth more than per dollar FDI in any other sector in terms of potential employment opportunity. This has a major policy implication for development policy discourse. However, the above conclusion should be considered as tentative at best because the figures included in the analysis are of "approved" FDI and prospective investment and employment, and not the realized ones.

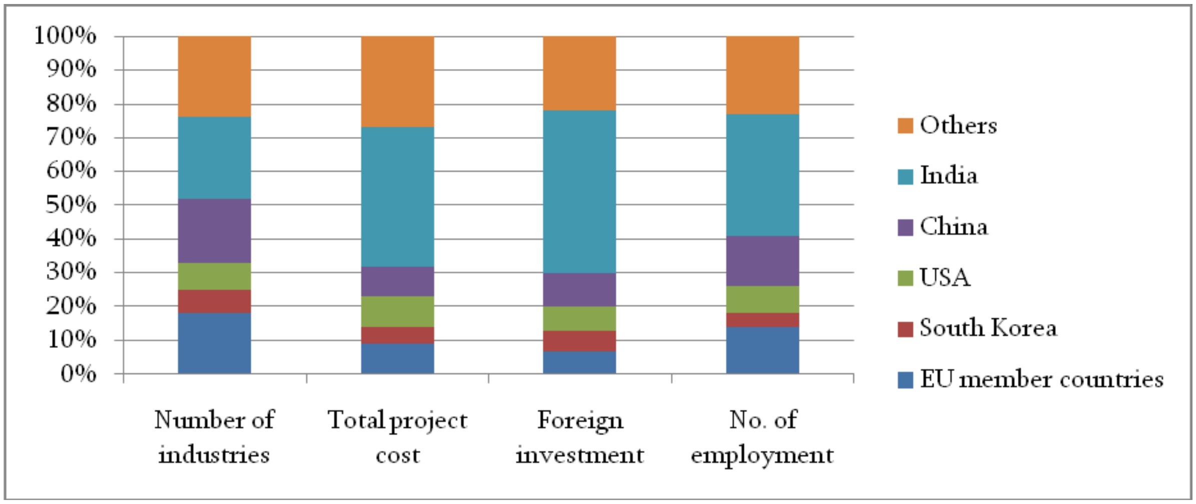
Figure 4: Sectoral composition of FDI, employment share and employment intensity index based on cumulative FDI data up to 2010/11



Source: Author's calculation based on DOI (2011), Note 6.

As far as the origin of FDI is concerned, Nepal received a bulk of its FDI from its southern neighbour, India. As can be seen in Figure 5, India accounts for 48 percent of all FDI in Nepal. This can be attributed to at least three factors. First, Nepal has a bilateral trade agreement with India, which is effective since the 1950s in various forms, and there are several Indian companies that have established their commercial presence in Nepal to exploit the investment-trade nexus. Second, Nepal and India share historical and cultural ties, which make the flow of foreign investment more amenable. Third, Nepal shares an open border with India. The other major FDI source countries for Nepal are China, the EU member countries, the United States (US) and South Korea. These top five investors account for 78 percent of approved FDI and 77 percent of employment potentials.

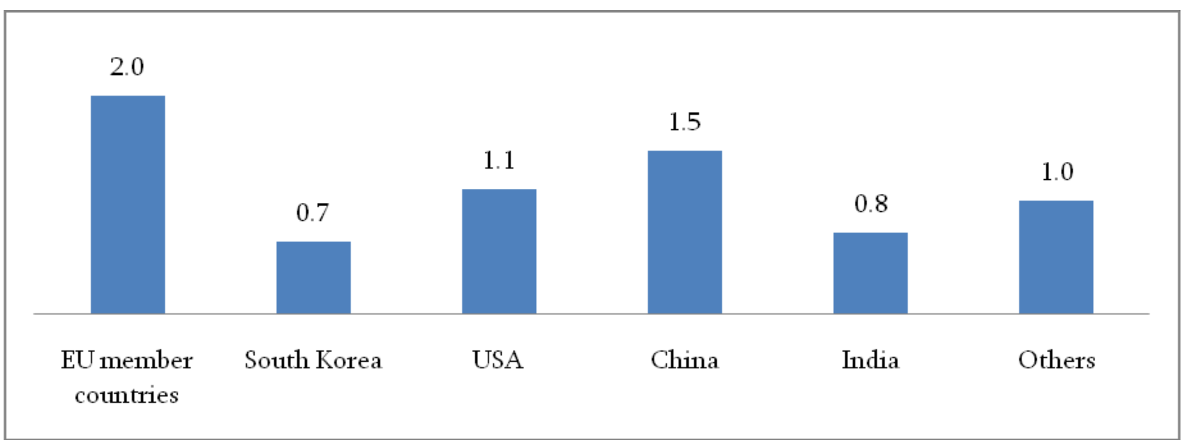
Figure 5: FDI-related indicators for the top five foreign investors in Nepal (based on cumulative figure, in percentage, upto 2010/11)



Source: Author's calculations based on DOI (2011), Note 6.

Although the EU member countries are the third largest in terms of approved FDI figures, they have the highest employment intensity (2) amongst all the foreign investors, compared to China (1.5) and India (0.8). Indeed, they surpass South Korea, the fifth largest foreign investor in Nepal almost by a factor of three (Figure 6).

Figure 6: Employment intensity index of the top five foreign investors in Nepal (based on cumulative figure upto 2010/11)



Source: Author's calculations based on DOI (2011), Note 6.

One of the major policy implications is that, from a development perspective, it is necessary for the GoN to actively promote investors from the members of the European Union by stimulating the demand side (through incentives and better investment climate) as well as the supply-side (through global arrangement that treats investments to LDCs favourably in the EU or in all the countries that are members of the Organisation for Economic Cooperation and Development (OECD) for that matter). During our discussions with the EU delegation, it was suggested that it would be in the interest of Nepal to attract investment from the small and medium enterprises from Europe rather than focusing on giant multinationals, which would find it more profitable to establish their presence in neighbouring countries such as China and India.[10]

It was mentioned by the representatives of two member countries of the EU that Nepal is not the best place to do business and that the political environment has had a dampening effect on the investment climate. For example, at least one project aimed at promoting investment in Nepal through the development of business incubation on information technology was dropped because of this. However, there is a political interest on the part of the present Government of Germany to combine development assistance with investment, and there is a potential for providing subsidized credit to German investors to invest in LDCs and low income countries.[11] This is something worth considering by other countries in the post-2015 development framework to provide a viable mechanism to ensure regular inflow of FDI to less fortunate countries. This is even more pressing in the context of the fact that Africa and the LDCs saw a third consecutive year of declining FDI inflows, with UNCTAD (2012: xiii) stating in no less clear terms that "[t]he poorest countries remained in FDI recession, with flows to the least developed countries(LDCs) retreating 11 percent to [US]$15 billion."

While the representative of the DFID-Nepal Office suggested that the UK government normally does not mix development assistance with commercial considerations, he sees more and more aid being tied to commercial transactions in the future taking a cue from the strategy adopted by the Chinese government.[12] However, we feel that it is less likely because this means going back to the previous-era where aid used to be predominantly commercially driven. Moreover, following the Paris Declaration, Accra Agenda of Action and Busan Partnership for Effective Development Cooperation, it has become extremely difficult to follow this path, although the Chinese government, which is not bound by these international commitments as a donor, can and may continue to do so. Indeed, a senior official from the Danish Embassy in Kathmandu considers it as an "old-fashioned way of handling development cooperation." Narrating the success of the Danish Business Partnership (DBP) programme, which supports commercial ideas and projects originating from Nepalese and Danish enterprises, she highlighted the importance of fostering collaboration between the private sectors of the two countries as a viable mode of promoting investment as well as facilitating technology transfer. The programme that includes matchmaking, transfer of know-how, capacity building and export promotion, has developed seven such partnerships so far and the Embassy is willing to expand it to between 20 and 30 in the coming years.[13]

This type of partnership could be a useful modality for other development partners to pursue, provided development assistance is leveraged to promote investment—both domestic and foreign (from the donor countries as well as from others).[14] This is particularly important in the context of the fact that domestic investment can crowd in foreign investment, as an investment expert remarks: “Unless and until domestic investment is attracted, Indians—the largest group of investors in Nepal—will not make investments. Unless and until Indian investors come in, other investors, in particular those from Western countries, will not invest in Nepal.”[15]

III. Opportunities and challenges

The idea that the recent surge in FDI has brightened the prospects for attracting more FDI has found traction amongst bureaucrats,[16] multilateral institutions[17] and researchers[18] alike. In the course of our interviews with various experts and stakeholders, this prospect was particularly highlighted,[19] although at least one senior government official and an expert were of the view that the investment prospects is not likely to improve in the short to medium term due to the prevailing political situation and policy fluidity.[20] This latter observation may have been bolstered by the failure of the government to promulgate the constitution. Against this backdrop, the section below enlists the opportunities as well as challenges facing investment climate in general and government's pursuit of attracting FDI in particular.

Opportunities for expanding investment

Overall opportunities can be divided into three clusters, namely: comparative advantage, market size and policy initiatives.

Comparative advantage

Resource endowment of any country that determines its comparative advantage has an important role to play in predicting the flow of FDI. Although this model is true from a neoclassical standpoint, particularly in the context of international trade (see, for example, Qui 2003)[21], we conjecture that it should apply to FDI predominantly targeting domestic market as well. Although there are different opinions about comparative advantage of Nepal, we rely on published studies and reports as well as interviews with experts and stakeholders[22] to determine the major sectors where Nepal has significant comparative advantage and/or where investment potentials are enormous. We follow a simple methodology to arrive at the final list.

First, we list the major sectors (and sub-sectors) identified by various studies/reports that have identified products in which Nepal has comparative advantage and/or are identified as sectors/sub-sector having investment prospects in columns 2 to 6 of Table 1. These studies/reports are: a study on export diversification prepared by SAWTEE and Action Aid Nepal[23]; a study on assessment of export potential conducted by the International Trade Centre[24]; Trade Policy of the Government of Nepal[25]; a report on foreign investment opportunity prepared by the Government of Nepal[26]; and Nepal Trade Integration Strategy[27]. In order to reduce the length of the list, we include only those sectors/sub-sectors that have been identified at least by two studies/reports as having export potential. Second, the list is then matched with the list we prepared based on our interviews with experts in column 7 of the table. Third, we provide scores in column 8 of the table by counting each of them. Here we provide equal weight to all the studies as well as to experts' opinions, which is less controversial. Finally, we prepare the list by classifying them into category I (with scores of 4 and 5); and category II (with scores of 2 and 3).

Table 1: Sectors/sub-sectors with comparative advantage and investment potential

Sector/sub-sector	Included in the studies/reports/publications					Suggested by experts	Score	Categorization of potential sector/sub-sector
	SAWTEE/ AAN (2007)	ITC (2007)	MoCS (2009)	MoCS (2010)	MoI/MoCS (2009)			
Hydro-electricity				√	√	√	3	II
Tourism	√		√	√	√	√	5	I
Health			√	√	√	√	4	I
Education			√	√		√	3	II
ICT (including BPO)	√		√	√	√	√	5	I
Carpets and woolen products			√	√	√		3	II
Readymade garments			√		√		2	II
Pashmina and silk products		√	√		√		2	II
Handicrafts		√	√	√			3	II
Tea	√	√	√	√			4	I
Large cardamom		√	√	√		√	4	I
Ginger		√	√	√			3	II
Pulses (incl. lentil)		√	√	√			3	II
Vegetable (incl. seeds)			√		√		2	II
Herbs and essential oils	√	√	√	√	√	√	5	I
Leather (raw and finished)	√	√	√		√		4	I
Handmade paper/ products thereof		√	√	√			3	II
Mining/mine-based					√	√	2	II

Source: SAWTEE and ActionAid Nepal (2007), Note 23; ITC (2007), Note 24; MOCS (2009), Note 25; MoI, MoCS and ENTREC (2009), Note 26; MOCS (2010), Note 27.

The final list thus produced shows that of the 18 sectors/sub-sectors included in the table, seven sectors/sub-sectors fall under category I, and 11sectors/sub-sectors fall into category II. One of the major limitations of the above exercise is that the ITC (2007) study does not include services sector at all. Otherwise, certain services such as hydro-electricity and education sectors could be seen as having very high prospects and so could have made it to a higher order in the list.

Market size

Although the size of the Nepalese market is considered relatively small when we compare it to populous neighbours such as India, China, Bangladesh and Pakistan, it is still a market of nearly 28 million people with a growing middle class. According to a study conducted by the Asian Development Bank (ADB 2010), based on a 2004 survey, Nepal had a middle and higher class population of 23.36 percent with a combined annual expenditure of US$10.72 billion in purchasing power parity (PPP) terms.[28] Although it is not possible to calculate recent expenditure figure due to a lack of date, the income figure has markedly increased in the recent period not least because 55.8 percent of the total households receive remittances from abroad, according to the latest Nepal Living Standard Survey.[29] Going by the Central Bureau of Statistics (CBS) data, annual income of the richest 20 percent of the population has increased from NRs. 40,486 in 2004 to NRs. 94,149 in 2011, thereby posting a growth of 133 percent.[30] Based on these figures, our back of the envelop calculation shows that the richest 20 percent population in the country had a combined income of US$7.26 billion in 2011. Converted in PPP terms, as done by the ADB study discussed above, this would translate into a combined annual income of US$ 14.68 billion.[31] Although this is not the disposable income, it shows that Nepal, as a country, has a huge purchasing power.

Moreover, by virtue of the various trade integration arrangements Nepal has entered into, the market size of Nepal is not restricted to its geographical boundary. Being a member of the World Trade Organization (WTO), Agreement on South Asian Free Trade Area (SAFTA) and Bay of Bengal Initiative for Multi-sectoral Technical and Economic Cooperation (BIMSTEC) mean that goods or services from Nepal have a very wide market access.[32] Better still, the Indo-Nepal Trade Treaty, last renewed in 2009, provides zero tariff access to almost all products manufactured in Nepal (except for some products in the negative list including alcohol, tobacco and perfumes of non-contracting party origin) to the Indian market.

Furthermore, being an LDC, Nepal enjoys duty-free and quota-free market access in most OECD countries, except the US and Japan, as well as in some of the south-south trading partners such as China, Turkey and Egypt. At the same time, Nepal is currently negotiating a free trade agreement with Bangladesh, which has agreed to provide zero tariff market access to select agriculture products to Nepal,[33] and it has also signed a Trade and Investment Framework Agreement with the US, which would, in all likelihood, be eventually converted into a bilateral trade agreement. Probably due to these favourable market access arrangements, Nepal is considered the country having the third-best indicator on "margin of preference in destination markets" amongst 132 countries included in the most recent Global Enabling Trade Report.[34] This shows that Nepal offers tremendous prospects for utilizing the trade-investment nexus.

One of the reasons for a number of Indian companies to have established their presence in Nepal after the onset of economic liberalization in Nepal, and in particular after the signing of a relatively more favourable Indo-Nepal Trade Treaty in 1996, was precisely to tap the vast Indian market. Although Indian authorities are notorious in imposing (often arbitrary and non-transparent) non-tariff barriers on Nepalese exports to their market,[35] the incidence of such barriers tends to be lower when the exporting company is an Indian company.[36] However, what is sorely lacking in the context of Nepal is an opportunity to exploit the trade-investment linkage targeting the Chinese market. The situation is not likely to change significantly in the near future because of accessibility problem beyond the Tibet Autonomous Region (TAR) and a lack of meaningful market access opportunity provided by China.[37]

Moreover, given the fact that the rapidly growing neighbouring countries—India and China—in general, and bordering Indian states in particular, are power hungry, there is a strong likelihood of FDI coming from these two countries as well as from Indian states like Bihar.[38] Entries of Indian companies such as GMR (a private sector venture)[39] and Satluj Jal Vidyut Nigam (a public sector undertaking)[40] as well as a Chinese company such as China Three Gorges Corporation[41] in Nepal are considered as precursors to the trend that is likely to set in.

However, on the flip side, it should also be understood that the expanding market size, often times, means there is increased competition for attracting investment. Sometimes a country loses in the race for attracting investment not because of its fault but because of the success of its competitor(s). Previously, Nepal was able to attract investment from India in the manufacturing of fast moving consumer goods (FMCG) partly because of the deteriorating investment climate in bordering states such as Bihar and Uttar Pradesh (UP). Now Bihar is becoming a favourite destination for investment due to improved economic growth, law and order situation, industrial relations and infrastructure development.[42] Similarly, Uttaranchal, a new state created after its separation from UP, although not as developed as Bihar, is offering several incentives to attract investors. This has resulted in many Indian companies relocating in that state and Nepal losing out in the race to attract investment.

Policy initiatives

Although the pace of reform has definitely been slow because of the nagging post-conflict transitional phase, reforms have paid off. For example, paying taxes and obtaining business permits in Nepal are becoming less complex.[43] Moreover, three recent developments in the policy arena are likely to provide the much needed shot in the arm for attracting investment—both local and foreign—particularly in the hydroelectricity sector.

First, the GoN has announced 2012/2013 as Nepal Investment Year (NIY), with a target of attracting US$1 billion worth of FDI in a year.[44] This figure is definitely quite ambitious because, even going by the approved investment data, Nepal will have to attract seven times more FDI than it did in 2010/11. However, this has sent a strong signal to the market that the government is serious about promoting FDI in the country.

Second, in order to provide fast-track approval for mega projects—both local and foreign—and facilitate their foray into the Nepalese business scene, the government has established the Investment Board, chaired by the Prime Minister. The Board plans to offer one-window solution to investors by getting all his/her issues, such as registration, licensing, immigration issues and bill clearance to even acquiring a mobile sim card, resolved from the same place.[45]

Third, in order to provide financing to medium to bigger size hydroelectricity projects (in excess of 25 MW) and construction of transmission and distribution lines, with participation of the Central Bank and other public sectors institutions, the GoN established the Hydropower Investment and Development Company in 2011. Although the company has started its operation with effect from 30 July 2012, in the initial stage, it is planning to lend to hydropower projects as a part of consortium financing together with other banks and financial institutions in the country.

Apart from these initiatives taken at the national level, the GoN has recently signed the Bilateral Investment Protection and Promotion Agreement (BIPPA) and Double Tax Avoidance Agreement (DTAA) with India, which has the largest stake in Nepal in terms of FDI. Although these agreements alone may not help in attracting FDI and they are no substitute for better investment climate,[46] they are still important in the sense that they do send some positive message to foreign investors that their investment would be protected in the host country and they have a legal recourse should there be a problem. Moreover, Nepal is actively engaged in the negotiations of the investment protection and promotion agreement within SAFTA. Once signed, this can help Nepal send positive signal to investors from other countries in the region, besides India, about its commitment to protect and promote investments from the region.

Challenges to leverage investment for development

While there are some typical challenges that each post-conflict LDC like Nepal faces in terms of attracting as well as retaining investment, Nepal faces certain sui generis constraints that are neither common nor explained by any theory. Given the fact that there is need to utilize FDI to achieve the development objectives such as poverty alleviation and inclusive economic growth pursued by the Government, these challenges become even starker. It is our assumption that these development objectives can be achieved, among others, through: i) meeting the financing needs for large infrastructure projects; ii) meeting the technology transfer requirement of the country; iii) provision of employment opportunities to poor, marginalized and vulnerable people such as women, dalits and other ethnic communities that are excluded from the development mainstream and making; and iv) retaining maximum possible value addition in the national economy. Therefore, for the purpose of this paper, these challenges can be broadly divided into four categories: i) political and governance-related; ii) legal, institutional and policy-related; iii) infrastructure-related; and iv) resource-related.

Political and governance-related

Ninety percent of the respondents of an enterprise survey conducted in Nepal in 2009 viewed that political instability is a “major to severe obstacle” constraining investment climate, and 70 percent of them thought that this was a “major obstacle”.[47] At the same time corruption, which is a proxy for governance, was considered a “major to severe obstacle” by 21 percent of the respondents, and none of them felt that this was a “major obstacle”.[48] Based on interviews conducted with various stakeholders and experts for the purpose of this study, we find that the situation has not improved much in the past three years or so, not least because they too singled out political instability and governance as the major constraints to investment climate.

Lengthening of the political transition has deterred Nepalese as well as foreign investors from making investments in Nepal due to the insecurity resulting from uncertainty.[49] This sentiment has become widespread, particularly after the failure of the government to write a new constitution, which was expected to chart out a new political course for the country to move towards a credible development trajectory.[50] While political environment as a problem has also been highlighted by Nepal Economic Outlook,[51] failure to promulgate the new constitution means that even local investors are shelving their investment plans and holding back on their commitments for the time being. In such a situation, it would be imprudent to assume that foreign investors will substantially increase their investments.[52]

The attendant fallout has been a constant deterioration in the quality of governance indicators, which creates uncertainty as well as impacts on the competitiveness of enterprises,[53] and perpetuates the culture of impunity. One of the extreme examples of this latter tendency is the state seizure by interest groups, which can go to any extent to declare strikes and resort to bandh combining violence with extremism, to make their demand met. The organizers of these strikes and bandhs are either oblivious of the costs of their actions to the economy in general, and production loss as well as the signal they send to investors in particular, or they are emboldened by the impunity surrounding political order.[54] What is surprising is that these kinds of activities are considered perfectly legitimate not only by strike enforcers, but also by public at large.

As if this was not enough, donation and extortion rises with the formation of each new political party, with the private sector getting jittery each time a party splits.[55] With the judiciary, considered a sacred institution in the past, too having come under the shadow of suspicion, there is a limited possibility for the governance situation to get any better any time soon.[56]

Legal, institutional and policy-related

Overlapping and often contradictory laws and institutional arrangements, differing priorities of various agencies of the government, coupled with serious gaps between policies and their actual implementation on the ground, are collectively responsible for the deterioration in the quality of investment climate in Nepal. Although these are not highlighted explicitly as the obstacles by the IFC enterprise survey, they are discussed in other literature and are confirmed as serious problems by experts and stakeholders during interviews. For example, an Implementation Evaluation of Foreign Direct Investment Policy in Nepal, commissioned by the Economic Policy Network—a joint initiative of the Ministry of Finance and the ADB—reveals that the fiscal incentives, including income tax relief provided by the Foreign Investment and Technology Transfer Act, 1992 and Industrial Enterprises Act, 1992, are nullified by the provisions of the amended Revenue Act and the New Income Tax Act.[57] Similarly, even if concerned foreign investors fulfill all the requirements and the DOI recommends for the provision of visa for those investors and their dependent family members, the Department of Immigration under the Ministry of Home does not provide such visas in a hassle-free manner.[58]

These problems arise mainly due to differing priorities of the different government agencies, with officials from other ministries not prepared to "own" the idea that increased foreign investment is indeed good for the economy. Moreover, there is a feeling that it is the sole responsibility of the Ministry of Industry or the DOI to attract and retain foreign investors. For example, the Ministry of Finance is singularly concerned about revenue generation with its Department of Internal Revenue and Department of Customs both remaining uncooperative while providing fiscal incentives to foreign investors.[59]

Regarding institutional arrangement, although the one window policy has been around for more than a decade, and the DOI was responsible to provide one stop facility to all the foreign investors, this has never been the practice, because all that DOI can do is to provide recommendations. Foreign investors are obliged to visit the Department of Immigration for the purpose of visa, the Ministry of Environment for conducting Environmental Impact Assessment (EIA) or Initial Environmental Examination (IEE) and the Department of Revenue/Customs for obtaining fiscal incentives/exemptions promised by various legislation. With the establishment of the Investment Board, there have been discussions going on as to whether it offers one window facility to foreign investors or it simply is "one more window".[60]

The problems on the policy side are twofold. First, there is no policy stability in the country, which is partly because of the prolonged political conflict. Second, even those sound policies that have been formulated are hardly implemented.[61] This predicament is aptly captured by Rana and Pradhan (2005:3) in the following words: "Government listens but no actions are taken". The gap between policy and implementation is due to a combination of factors as highlighted in a study focusing on South Asian LDCs, including Nepal. First, policy itself could be faulty, if the implementation is found lacking even after repeated attempts. Second, public officials choose not to implement some policies, either because the policies are top-down or externally driven and the public officials do not "own" them or because they do not have the "capacity" to implement the policies.[62]

Infrastructure-related

The IFC enterprise survey finds that two major infrastructure-related constraints are electricity and transport, with 57 percent of the enterprises surveyed suggesting electricity as the "major to very severe obstacle" and 16 percent finding this as the "most important obstacle". The corresponding figures for transport were much lower, at 25 and 2 percent, respectively.[63] However, other studies find both of these as the major constraints,[64] which is vindicated by the interviews conducted with stakeholders and experts for the purpose of this study. Both the factors dampen investors' confidence and deter them from making or retaining, let along increasing, investment in Nepal because they severely erode the competitiveness of enterprises due to the higher transaction costs they inflict.[65]

Since the problem of electricity shortage is not likely to be resolved anytime soon, the alternative is to invest in captive generators, which are very expensive to run due to rising fuel prices. To add to their woes, the public sector natural monopoly, the Nepal Oil Corporation, has remained incapable of supplying diesel in a timely manner due to the loss it has been incurring in the supply of fuels. When there is a shortage of fuel, it is not possible to operate the industry anymore, but some of them are forced to run their generators by purchasing fuels from the black market.[66] This is particularly the case for some industries involved in manufacturing iron and steel, utensils, plastic, vaccine and medicine, where power interruption cannot be tolerated even for a short period of time.[67]

As far as transport infrastructure is concerned, the underdeveloped nature of Nepal's transport sector, coupled with the dilapidated nature of its road infrastructure, is highlighted by a number of global reports, including the Enabling Trade Report[68], Global Competitiveness Report[69] and Logistics Performance Indicators[70]. For example, according to the Global Enabling Trade Report 2012, although Nepal's overall ranking appears reasonably good (better than Bangladesh), it is due largely to better performance on two indicators. First, airport density is bound to be higher in a country with mountainous terrain like Nepal, where road network is rudimentary and not yet fully connected to all the district headquarters.[71] Second, although the percentage of paved road is reported to be 55.5 percent in Nepal this is due to the fact that the total road length itself is limited in the case of Nepal. Moreover, the reported figure does not take into account the condition of the road, which means even dilapidated roads are categorized as paved road, irrespective of their condition.

Table 2: Availability and quality of transport infrastructure in South Asia

Country/Indicators (N = 132)	Bangladesh		India		Nepal		Pakistan		Sri Lanka	
	R	S	R	S	R	S	R	S	R	S
Transport infrastructure (overall)	126	2.7	76	4.0	96	3.5	75	4.1	58	4.4
Airport density, number per million population	132	0.0	128	0.1	42	0.9	116	0.2	131	0.0
Trans-shipment connectivity index, 0–100 (best)	96	55.1	18	84.5	-	-	27	79.5	23	81.7
Paved roads, % of total	120	9.5	69	49.3	63	55.5	59	65.4	43	81.0
Quality of air transport infrastructure, 1–7 (best)	109	3.5	62	4.7	113	3.4	78	4.3	56	4.9
Quality of railroad infrastructure, 1–7 (best)	74	2.5	24	4.4	128	1.1	60	2.8	38	3.8
Quality of roads, 1–7 (best)	102	2.9	78	3.4	119	2.5	72	3.7	45	4.5
Quality of port infrastructure, 1–7 (best)	105	3.4	76	3.9	125	2.6	66	4.1	42	4.9

Note: R = Ranking; S = Score

Source: Author's compilation based on World Economic Forum (2012a).

Given the fact that 79.15 percent of total export and 81.51 percent of import take place via land route, the salience of the quality of road transportation cannot be overemphasized. Therefore, the most important index for us is the "quality of roads", in which Nepal finds itself at the bottom of the list with a score of 2.5 out of 7, and ranking of 119 out of 132 countries included in the report. This is vindicated by a study which asserts that most of the road traffic from Kathmandu (the capital city) and major business centres to all major border points to India has to travel through 36 km Mungling-Narayanghat road, which is the major bottleneck due to poor road conditions and frequent landslides during rainy seasons.[72] Moreover, a number of bridges along the Hetauda to Pathalaiya sector, which are used by east-bound cargos, are only single lane and could become a major constraint as traffic increases. Congestion at the Birgunj border point is a frequent phenomenon as the custom yard for road-based cargo is inadequate.[73]

During the field survey conducted by SAWTEE in January 2012 to assess trade-related constraints faced by Nepal, most of the respondents, including customs officials, customs agents, freight forwarders and traders complained of the narrowness as well as poor quality of road. During the interview with the Chief of Birgunj Customs Office, he informed that the GoN has set aside a budget of NRs. 900 million for the widening and repair of road, but the Department of Road, which is responsible for these tasks, has been moving at a snail's pace, thereby leading to further deterioration in the quality of road.[74]

The field visit also provided the opportunity to get a first-hand assessment of the road condition, which helped further confirm that the condition of road is not only poor, but also deteriorating due to heavy traffic load on the one hand and a lack of maintenance on the other. It was also found that the condition of road at the other side of the border is worse than what exists on the Birgunj side. The filed visits at Kakarvitta-Panitanki and Biratnagar-Jogbani border points too revealed that roads are too narrow on the Indian side and there are no truck yards.

Added to these is the fact that trucks carrying export and import cargos have to compete with pedestrians, horse carts, rikshaws and tempos for space on the road, leading to further congestion. That said, there is a move afoot to expand the width of the road on the Nepal side in Birgunj, although this may not prove extremely helpful without commensurate expansion on the Indian side. Another factor that affects transportation costs in Nepal is the prevalence of cartel among truck operators, who have formed a syndicate and rotation system for the operation of trucks. Due to the market power possessed by such syndicates, they are able to charge near-monopoly fares for the transportation of both import and export cargoes. What is surprising is the fact that despite their actions being illegal as per the provisions of the two Acts (Consumer Protection Act and Competition Promotion and Market Protection Act) as well as denounced by the Supreme Court, the government has failed to bring them to book. This is not only because of the presence of weak government ensuing lack of political will, but also because of the physical threat exerted by transport entrepreneurs and their goons to those who try to disobey the system.

Resource-related

Although there are several problems that the investors face under this category, we focus on three key resources, human, financial and technological resources.

Human resources

There are several levels at which the issue of human resource constraints should be looked at. First, Nepal does not have enough educated human resources endowed with skills required for being productively employed in manufacturing and services sectors. Although there has been some improvement in the general level of literacy as well as education in the country due to higher levels of investment made in the education sector, Nepal has a long way to go before achieving the quantitative as well as qualitative targets on education.[75] Even those who are educated have already migrated abroad in search of greener pasture. This is vindicated by the fact that Nepal has the highest incidence of brain drain in South Asia, followed by Bangladesh, as revealed by the Global Competitiveness Report.[76]

Second, but related issue is that although most industries are operating below capacity due to electricity and other problems, the situation has arisen whereby the industrialists are mulling over scaling down their production due to acute shortage of human resources.[77] Due to the shortage of workers, wages have shot up such that Nepal has become the country with the highest wage overhead in South Asia.[78]

Finally, those workers that have been left behind are heavily unionized and are apt at demanding higher wages and facilities without making commensurate increase in their own productivity.[79] They are politically motivated, and operate more as sister wings of their political parties than as a productive force concerned about enhancing the productivity of the enterprise, letting business survive in the fiercely competitive market and wait to share the reward later, let alone struggling for the emancipation of workers.[80]

Financial resources

As for access to finance, IFC (2009) finds that only 74 percent of the firms have a bank account and 39 percent have a line of credit or a loan from a financial institution. It also states that most firms rely on internal funds to finance the bulk of their investments and their working capital needs.[81] Three years on, some improvement in the situation is shown by the Doing Business Report.[82] However, it is still a bit nuanced and has to be understood differently depending on the size and origin of the company. While there is little problem in terms of access to finance (in particular obtaining credit from banks) for relatively large companies and companies of foreign origin, according to a survey of small and medium enterprises conducted in 2011, it is highly restricted in the case of micro, small and medium enterprises.[83] According to the survey, the major reasons for the reluctance of these enterprises to obtain loan from banks are in the following order: high interest rate; collateral-related problems; and lengthy and burdensome process.[84]

Access to finance should still be considered a minor hindrance for foreign investors in establishing their presence in Nepal due to two major reasons. First, foreign investors—particularly multinational corporations—are generally considered cash rich and having deep pockets. The whole idea of investing in another country is to utilize the excess funds they have to access foreign markets or exploit other comparative advantages of the host country. Second, as noted above, banks and financial institutions in Nepal are generally more inclined to offer loans to foreign investors at cheaper rates as compared to local entrepreneurs. This is admittedly due to risk perception, as Nepalese bankers believe that foreign investors are less likely to default due to their generally well-established reputation and credibility in the national as well as international markets.

However, there could be occasions when foreign investors would like to make use of the local financial market for financing their projects as well as meet their working capital requirements. In such a situation, the Nepalese market is not considered attractive for those investors because the capital market in the country is relatively under-developed, and when it comes to obtaining large amount of loan, even banks and financial institutions are constrained due to the single borrower limit imposed by the Central Bank of the country. Since the single borrow limit is 25 percent for funded facilities (such as loans and advances) and 50 percent for non-funded facilities (such as letter of credit and bank guarantee)[85] and the several class "A" commercial banks still have their core capital below NRs. 2 billion, the maximum amount of funded-facility they can provide to an enterprise or a group is less than NRs. 500 million. This amount is not at all enough for large infrastructure projects such as hydropower (for which cost of generating one kilowatt of power on average is NRs. 150 million[86]) and other projects such as road, rail or airport construction.

Technological resources

As for the issue of technology, based on various indicators prepared by international organizations, such as the Global Competitiveness Report at the macro level, or the IFC Enterprise Survey at the micro-level, Nepal ranks the lowest in the region. For the macro level analysis, we take two indicators included in the Global Competitiveness Report. The first one is "technological readiness", which "measures the agility with which an economy adopts existing technologies to enhance the productivity of its industries" (WEF 2012b: 6). The second indicator relates to "innovation", which is "particularly important for [developing] economies as they approach the frontiers of knowledge and the possibility of generating more value by only integrating and adapting exogenous technologies tends to disappear" (ibid: 7). Table 3 provides a comparative picture of these indicators for South Asian countries.

Table 3: Technology-related indicators for South Asian countries, 2012-2013

Country (N = 144)	Technological readiness		Innovation	
	Rank	Score	Rank	Score
Bangladesh	125	2.74	123	2.6
India	96	3.26	41	3.6
Nepal	129	2.63	133	2.4
Pakistan	118	2.9	77	3.1
Sri Lanka	89	3.45	58	3.3

Source: WEF (2012b). Note 69.

The table shows that two developing countries of the region, namely India and Sri Lanka, are well placed in the technological frontiers because they have better indicators than many other developing countries outside the region (not shown here). Although Pakistan's ranking and score for the "technological readiness" indicator may not be considered good enough for a developing economy, its ranking on the innovation front is satisfactory. However, two LDCs in the region—Bangladesh and Nepal—lag far behind other countries, but Nepal is the worst performer in the region along both the indicators presented in the table. In terms of innovation, Nepal ranks 11th from the bottom, although it is marginally better placed in terms of technological readiness on which it ranks 15th from the bottom.

Similarly, at the micro-level, based on the data compiled by IFC, Adhikari (2012b) provides four indicators of technological sophistication for South Asian countries and compares them with global as well as East-Asia and the Pacific averages[87] (Table 4). While the table paints a bleak picture for South Asian countries in general, it shows that Nepal is a laggard in all the categories but one relating to the percentage of firms using e-mail to interact with client suppliers. Although it does not perform well on the indicator relating to firms having their own website, its figure is slightly better than Bangladesh and Pakistan.

Table 4: Technology and innovations indicators at the micro-level

Economy	Year	Percentage of firms			
		with an internationally-recognized quality certification	using technology licensed from foreign companies*	having their own web site	using e-mail to interact with clients/suppliers
World	…	16.5	15.2	35.1	64.5
East Asia & Pacific	…	19.2	18.7	29.2	64.1
South Asia	…	9.4	5.6	22.8	43.6

Afghanistan	2008	8.5	10.8	24.1	46.6
Bangladesh	2007	7.8	3.8	15.7	39.7
Bhutan	2009	5.4	6.9	30.1	58.5
India	2006	22.5	5.3	31.1	56.7
Nepal	2009	3.1	0.6	23.3	46.2
Pakistan	2007	9.6	2.7	16.6	26.8
Sri Lanka	2011	9.1	9.3	18.6	30.5

Source: Adhikari (2012b), Note 87 based on IFC Enterprise Surveys.

Although FDI is used as a means to transfer technology, this too has not been encouraging in the context of South Asia in general, and Nepal in particular. For example, as provided for in the Global Competitiveness Report 2012-2013, Nepal and Pakistan, with a score of 3.8/7 each, are the two countries in the region that have not been able to leverage FDI for technology transfer, while India and Sri Lanka, with a score of 4.9/7 each, have done much better on this front. Despite being an LDC, Bangladesh, with a score of 4/7, is an average performer on this front and certainly better than Pakistan. The country level data prepared by DOI (2011) shows that during the seven-year period between 2004/05–2010/11, only 5 percent of the foreign investors made a commitment to transfer their technologies to Nepal. However, these were only commitments and whether or not they have been realized is not clear because the DOI does not have any mechanism in place to monitor whether the commitments made by foreign investors were actually materialized or not.[88]

Given the fact that Nepal is currently passing through political transition and it faces serious resource constraints, it is not possible to solve all the problems simultaneously in the short run. However, there are some low hanging fruits that can be picked provided there is a political will to leverage FDI for achieving the country's development objectives. One such fruit is the establishment of special economic zones (SEZs) that will help alleviate the constraints relating to power shortage, conditions of other infrastructure such as road infrastructure, militancy of trade unions, and restricted access to credit. However, constraints such as absence of requisite human capital and technology, which are equally necessary to attract foreign investment in Nepal may not be resolved merely through the establishment of these zones. While separate incentive mechanism should be put in place to overcome these latter constraints, SEZs can become powerful new route to enhancing productivity as well as competitiveness of export-oriented manufaturing enterprises, where foreign investors tend to be attracted.

As discussed in SAWTEE (2012), the problem, however, lies with the inability of the Government to pass the SEZ Bill from the Parliament, despite the fact that establishing SEZs was mentioned explicitly in the new Industrial Policy of 2010. The cabinet endorsed the SEZ Bill in January 2009 and it was registered at the Parliament Secretariat on 31 March 2009 and presented at the full house of Parliament on 19 April 2009.[89] One of the plausible explantations for this apathy is ideological. Since a large majority of members of the now dissolved Constituent Assembly, which also acted as the Parliament of the country, were either leftist or left-leaning, they viewed SEZs as one more ploy from the "capitalists" to exploit "labour".

However, as noted by SAWTEE (2012), this perception is ill-founded at least for two reasons. First, mean wages of workers in SEZs or export processing zones (EPZs) globally are higher than their counterparts working in industries catering mainly to the domestic market. Similar to wages, reports of benefits generally show that EPZs are more likely to provide benefits, such as health care and social security, than other sectors of the economy.[90] Second, the SEZ Bill merely seeks to balance the rights and obligations of workers vis-à-vis their employers and create some predictability in industrial climate. It is perfectly logical, within the ambit of the SEZ, for workers and their employers to enter into a compact whereby workers would be provided with decent wages, benefits as well as social security measures in return for their contribution to enhancing productivity of the factory and refraining from resorting to harsh measures such as strikes to make their greivances redressed, should they occur. Indeed the new Industrial Policy of the Government of Nepal has already envisaged the adoption of flexible labour policy as well as introduction of "no work no pay" policy,[91] and the SEZ Bill is just an extension of that provision.

Conclusion and recommendations

The above analysis shows that despite the growing salience of FDI, not only for traditional business-related activities but also for financing development, LDCs in general have not been able to tap this opportunity. South Asia as a whole has been receiving reasonably good amount of FDI, although the total FDI received by the region represents a meager 2.6 percent of the global FDI inflow. Even within this, 80 percent of FDI went to India, leaving other seven countries in the region with a share of remaining 20 percent. It is disheartening to note that despite a recent growth in FDI achieved by Nepal, the country still receives the lowest amount of FDI in the region.

Nepal's FDI potential is heavily under-exploited, despite the fact that the country offers a huge potential not only for market seeking investors but also resource seeking ones. A country of nearly 28 million people, where the richest 20 percent of the population has a combined income of US$ 7.26 billion, cannot be considered a small market by any standards. Besides, due to favourable market access opportunities it has received, particularly in the European and Indian markets, market-seeking investors should find it worthwhile to invest in Nepal. Resource-seeking investors can invest in Nepal to tap the immense hydropower potentials. Besides, those foreign investors, who are now mature enough and can take long-term risk, could make investment in other infrastructure projects such as road, rail and airport construction.

On the flip side, however, Nepal does not seem to offer a hospitable investment climate for foreign investors. Although there are several reasons that could deter investors from making long term investment in Nepal, three problems stand out. First, the political instability and resultant policy and legal uncertainty means foreign investors would think twice before investing in Nepal. Second, poor infrastructure, in particular electricity and road network, which raises the cost of doing business in Nepal, works as a strong disincentive not only for foreign investors, but also for local investors, to invest in Nepal. Third, militancy of trade unions, which have become emboldened particularly in the aftermath of the declaration of Nepal as a republic, has created havoc for the overall business climate of the country. Their never-ending demand for increased benefits/facilities, which, according to them, should not necessarily be linked to their productivity, coupled with their cavalier attitude towards work and poor work ethics, means that foreign investors would most likely invest in other countries or locations (such as those Indian states which are Nepal's immediate neighbours) where they can lead a comfortable life as well as earn a reasonable amount of profit.

Given the imperatives to attract a growing amount of foreign investment surmounting the challenges discussed above, the following recommendations, which are divided based on their time horizons, are worth taking note of:

In the short term

- In order to attract investment as well as to compete with various neighbouring states in India offering favourable incentives to attract investments, Nepal needs to immediately enact the legislation on special economic zone (SEZ) and expedite the process of completing SEZs, which are under construction. The SEZs should, at a bare minimum, provide required infrastructure facilities and strictly implement flexible labour laws that allow for adherence to strict disciplines, including linking of wages with productivity, imposing no-work no-pay system, and imposing ban on strikes.

- Power problems should be resolved through reduction in leakage, operating thermal plants to the fullest extent possible and importing electricity from India. A market-based mechanism should be fixed for the adjustment of fuel prices.

- Board of Investment should be empowered further for providing fast track approval to big projects. Contradictory provisions in various legislation should be streamlined and ambiguities corrected so as to provide predictability to investors. A system should be devised such that facilities provided by laws are automatically granted to investors.

- Enforcing of strikes and bandhs through violent means should be banned.

- Current level of investment made on education should be maintained and skill development trainings should be provided by mobilizing government resources as well as those of the private sector and donors.

- Resources and expertise should be provided to DOI for monitoring the developmental impact of FDI, including preparation of database on the proposed, approved and realized flow of FDI, employment generated, tax paid and corporate social responsibility projects implemented by them.

In the medium to long term

- Policy making process should be made inclusive, capacity of government officials should be enhanced and strict reward and punishment system should be devised within the bureaucracy.

- A sustained improvement in business climate should be achieved, among others, through consistency in the application of policy and law, adequate provisioning of infrastructure facilities and a proactive agenda for the development of skill and technology.

- Foreign and local investment—both public and private or combinations thereof—should be mobilized for the construction of hydroelectricity projects (mainly focusing on reservoir type) and for the construction of roads and trade corridors.

Notes

[1] This paper builds on the sub-sections "Investment" and "Technology" contributed by the author to the European Report on Development: Nepal Case Study prepared by Posh Raj Pandey, Ratnakar Adhikari and Bandita Sijapati and submitted to Overseas Development Institute (ODI), London. The author is grateful to Chandan Sapkota for his research assistance, James Mackey and Posh Raj Pandey for their comments on the Case Study, and Puspa Sharma for his comments and suggestions on this version of the paper. The author is fully responsible for all the remaining errors.

[2] UNCTAD. 2012. World Investment Report 2012: Towards a New Generation of Investment Policies. New York and Geneva: United Nations.

[3] ibid.

[4] ibid.

[5] ibid.

[6] DOI. 2011. Industrial Statistics: Fiscal Year 2010/11. Kathmandu: Department of Industry, Government of Nepal.

[7] Interview with Mr. Dhruba Rajbamshi, Director General, DOI (Kathmandu, 28 June 2012).

[8] Ncell is now the largest mobile service operator in Nepal. According to media reports, the company invested US$484 million to purchase the shares of Spice Nepal [See http://m.nepalnews.com/2008/sep/sep28/news07.php

(accessed 23 July 2012)]. Another media report suggested that the company was planning to make an investment of US$250 million between 2009 and 2010 to upgrade its infrastructure [See http://www.cellular-news.com/story/36869.php (accessed 23 July 2012)].

[9] This is based on the "employment intensity index of FDI", which has been calculated by dividing the percentage of proposed employment to be generated by the FDI by the total amount of approved FDI. The indices are provided upto two decimal points for the sake of accuracy whereas the shares of various sectors in FDI value and employment have been rounded up.

[10] This would also facilitate technology transfer to Nepal because they use technologies that are suitable for and adaptable to the prevailing country context. Interview with Dr. Giap Dang, European Delegation to Nepal (29 June 2012, Kathmandu).

[11] Interview with OJ Kruek, Philippe Kruschel and Himadri Palikhe, GIZ (5 July 2012, Lalitpur).

[12] Interview with Mr. Navin Dahal (24 June 2012, Kathmandu).

[13] Interview with Ms. Maria Ane (6 July 2012, Kathmandu).

[14] Interview with Ms. Maria Ane (6 July 2012, Kathmandu).

[15] Interview with Mr. Keshab Acharya, Former Advisor, Ministry of Finance, and an investment expert (30 June 2012, Kathmandu).

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[19] Interviews with Prof. Bishwambher Pyakuryal, Tribhuvan University (1 July 2012, Lalitpur); Radesh Pant, Investment Board (3 July 2012, Kathmandu); Mr. Dhruba Rajbamshi (28 June 2012, Kathmandu).

[20] Interviews with Mr. Dhruba Rajbamshi (28 June 2012, Kathmand) and Mr. Kehab Prasad Acharya (30 June 2012, Kathmandu).

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[22] Interviews with Mr. Purushottam Ojha (23 June 2012, Kathmandu); Mr. Jib Raj Koirala (24 June 2012, Kathmandu); Mr. Prithvi Raj Ligal (25 July 2012, Kathmandu); Dr. Mohan Mani Sainju (26 July 2012, Kathmandu); Mr. Navin Dahal (24 July 2012, Kathmandu); Mr. Dhruba Rajbamshi (28 June 2012, Kathmandu); Mr. Kehab Prasad Acharya (30 June 2012, Kathmandu); Prof. Bishwambher Pyakuryal (1 July 2012, Kathmandu); and Radesh Pant (3 July 2012, Kathmandu).

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[30] ibid.

[31] Calculated by multiplying current income by a factor of 2.03, as done by the World Development Indicator of the World Bank. See http://databank.worldbank.org/ddp/html-jsp/QuickViewReport.jsp?RowAxis=WDI_Series~&ColAxis=WDI_Time~&PageAxis=WDI_Ctry~&PageAxisCaption=Country~&RowAxisCaption=Series~&ColAxisCaption=Time~&NEW_REPORT_SCALE=1&NEW_REPORT_PRECISION=0&newReport=yes&ROW_COUNT=2&COLUMN_COUNT=13&PAGE_COUNT=1&COMMA_SEP=true (accessed 20 January 2013).

[32] Adhikari, Ratnakar and Paras Kharel. 2011. Nepal and SAFTA: Issues, Prospects and Challenges. Paper submitted to Commonwealth Secretariat, London.

[33] SAWTEE. 2011. "Nepal and US ink TIFA." Trade Insight 7(2): 4.

[34] Nepal's score was 67.9/100 against 93.8/100 (the highest score, for Malawi) followed by 72.4/100 (the second highest score, for Mauritius) (See WEF. 2012a. Global Enabling Trade Report: Reducing Supply Chain Barriers. Geneva: World Economic Forum.

[35] See, for example, SAWTEE. 2012. A study on Nepal-India Trade. Report submitted to USAID/NEAT Activity, Kathmandu.

[36] Adhikari (2012a). Note 18.

[37] ibid. Both—the bilateral trade agreement with China, and the market access it has provided as a part of the commitment it made at the Hong-Kong Ministerial Conference of the WTO—have not been terribly helpful for Nepal to tap the Chinese market.

[38] Interview with Prof. Bishwambher Pyakuryal (1 July 2012, Kathmandu) and Radhesh Pant (3 July 2012, Kathmandu).

[39] A consortium comprising GMR Energy Limited, GMR Infrastructure Limited (GIL) and Italian-Thai Development Project Co. has signed a Memorandum of Understanding (MoU) with the GoN for developing the 900 MW Upper Karnali Hydro-electric Project. See http://www.gmrgroup.in/Energy/Upper_Karnali_Project.html (accessed 31 July 2012).

[40] Sutlej Jal Vidyut Nigam, a company owned by the Central Government of India and State Government of Himachal Pradesh, signed an MoU with GoN on 2 March 2008 to implement the Arun-3 Hydropower Project with a minimum installed capacity of 402 MW. See http://www.wec.gov.np/downloadfile/MOU%20with%20SJVN%20on%20Arun%203%20HEP_1320220226.pdf (accessed 31 July 2012).

[41] The GoN and the China's Three Gorges Corporation (CTGC) signed an MoU for the construction of the 750 MW West Seti project on 29 February 2012. See http://www.ekantipur.com/the-kathmandu-post/2012/02/29/money/govt-china-company-ink-west-seti-mou/232132.html (accessed 31 July 2012).

[42] Interview with Prof. Biswambher Pyakuryal (1 July 2012, Kathmandu).

[43] Afram and Del Pero (2012). Note 17.

[44] Poudel, Bhoj Raj. 2012. "Investment Year in trouble post CA demise." Republica, 30 May 2012. Available at http://www.myrepublica.com/portal/index.php?action=news_details&news_id=35677 (accessed 28 July 2012).

[45] See http://www.whynepal.com/entrepreneurship/what-is-investment-board-nepal-ceo-radhesh-pant-answers/ (accessed 31 July 2012).

[46] Yackee, Jason Webb. 2010. "Do Bilateral Investment Treaties Promote Foreign Direct Investment? Some Hints from Alternative Evidence."Virginia Journal of International Law 51(2): 397-441.

[47] IFC. 2009. Nepal Enterprise Survey. Washington, D.C.: The World Bank Group.

[48] ibid.

[49] Ghimire and Poudel (2012). Note 16.

[50] Poudel (2012). Note 44.

[51] IIDS. 2012. Nepal Economic Outlook 2011-2012. Kathmandu: Institute for Integrated Development Studies.

[52] Poudel (2012). Note 44.

[53] Ghimire and Poudel (2012). Note 16.

[54] The Himalayan Times (N.d.) “The thriving bandh culture is threatening to topple the economy, with no easy respite in sight.” Available at http://www.thehimalayantimes.com/perspectives/fullnews.php?headline=The+thriving+bandh+culture+is+threatening+to+topple+the+economy%26sbquo%3B+with+no+easy+respite+in+sight&newsid=MTIxNw (accessed 1 August 2012).

[55] “Politics of intimidation has caused the business houses to panic” writes The Himalayan Times in its editorial suggesting that such as tendency will have a telling impact on investment prospects of the country. See The Himalayan Times. 2012. “Stop Extortions.” 27 June 2012. Available at http://www.thehimalayantimes.com/fullNews.php?headline=Stop+extortion&NewsID=337522 (accessed 1 August 2012).

[56] Based on an interview with an expert, who preferred to remain anonymous.

[57] Similarly, there is duty draw back facility to those who export their products, but they have to face many difficulties, including long waiting periods, to realize the facility. Sometimes they are given Government Bond instead of cash, which may be of no value to the foreign investors. See Rana, Madhukar SJB and Stalin Man Pradhan. 2005. “Implementation Evaluation of Foreign Direct Investment Policy in Nepal.” Policy Paper 1 (August). Kathmandu: Economic Policy Network.

[58] Both the assertions were validated during our interview with Mr. Dhruba Rajbamshi (28 June 2012, Kathmandu). He further mentioned that there were complaints from 4-5 investors that their visas had not been renewed despite them having fulfilled all the formalities, thereby sending wrong signals to foreign investors.

[59] Interview with an expert, who preferred to remain anonymous.

[60] Interview with an expert, who preferred to remain anonymous.

[61] Ghimire and Poudel (2012). Note 16.

[62] Adhikari, Ratnakar. 2011. Political Economy of Aid for Trade: An Inquiry into Supply-side Constraints Facing South Asian Least Developed Countries. PhD Thesis. Coventry: Warwick University.

[63] IFC. 2009. Note 47.

[64] ADB/DFID/ILO. 2009. Country Diagnostic Studies, Nepal: Critical Development Constraints. Manila: Asian Development Bank; Adhikari (2011), Note 62; SAWTEE (2012), Note 35; Ghimire and Poudel (2012), Note 16.

[65] Ghimire and Poudel (2012). Note 16.

[66] SAWTEE (2012), Note 35; and interview with Mr. Dhruba Rajbamshi (28 June 2012, Kathmandu).

[67] Interview with Mr. Dhruba Rajbamshi (28 June 2012, Kathmandu).

[68] WEF (2012a). Note 34.

[69] WEF. 2012b. Global Competitiveness Report. Geneva: World Economic Forum.

[70] World Bank. 2012a. Connecting to Compete: Trade Logistics in the Global Economy. Washington, D.C.: The World Bank.

[71] Rajkarnikar, Pushpa Raj. 2010. “Adequacy and Effectiveness of Logistic Services in Nepal: Implication for Export Performance” ARTNET Working Paper Series, No. 79, April. Bangkok: Asia-Pacific Research and Training Network on Trade.

[72] ibid.

[73] ibid.

[74] See SAWTEE (2012), Note 35 for further details.

[75] Adhikari (2011). Note 62.

[76] WEF (2012b). Note 69.

[77] The Himalayan Times. 2012. "Labour shortage hits small businesses." 26 April 2012.

[78] SAWTEE (2012). Note 35.

[79] Shakya, Sujeev. 2009. Unleashing Nepal: Past, Present and Future of the Economy. New Delhi: Penguin Press; Sapkota, Chandan. 2011. "Imprudent unions & weak industries." Republica, 27 August 2011.

[80] Most of the experts and stakeholders interviewed concurred with the idea that labour militancy has caused severe damage to investment climate facing the country.

[81] IFC (2009). Note 47.

[82] World Bank. 2012b. Doing Business 2013: Smarter Regulations for Small and Medium-Size Enterprises. Washington, D.C.: The World Bank Group.

[83] Sharma, Sudhindra and Bal Krishna Khadka. 2011. Nepal Business Climate Survey: 2010 Report. Kathmandu: Interdisciplinary Analysts and The Asia Foundation.

[84] ibid.

[85] Nepal Rastra Bank. 2010. "Provisions relating to Single Obligor and Limitation of the Sectoral Credit and Facilities", Directive No. 3/067, Banks and Financial Institutions Regulation Department, included in Unified Directives Issued by Nepal Rastra Bank to the Licensed Banks and Financial Institutions, July 2010. Baluwatar: Nepal Rastra Bank.

[86] Poudel, Keshab. 2013. "Power Cut: Not Easy to Solve." New Spotlight 16 (15), 25 January 2013. Available at http://www.spotlightnepal.com/News/Article/nepal-loadshedding-power-cut-not-easy-to-solve (accessed 3 February 2013).

[87] Adhikari, Ratnakar. 2012b. Technological capacity and technology transfer issues in South Asia. Paper presented at the Regional Consultation on Trade, Climate Change and Food Security, 20–21 December 2012. Kathmandu: SAWTEE and Oxfam (Novib).

[88] Pandey, Posh Raj, Ratnakar Adhikari and Bandita Sijapati. 2012.. European Report on Development: Nepal Case Study. Report submitted to Overseas Development Institute (ODI), London.

[89] Humagain, Mukul. 2010. "Bills gather dust in parliament while private sector fumes." The Kathmandu Post, 10 January 2010.

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[91] See section 8.3 of the Policy. MoI. 2010. Industrial Policy 2010. Kathmandu: Ministry of Industry, Government of Nepal.