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OPINION IN LEAD

Making Nepal FDI-ready in the time of COVID-19

COVID-19 pandemic has made external financing such as the ones from the foreign direct investment (FDI) even more necessary for economic development. However, the unfavourable scenario created by the pandemic that has diminished investor's confidence makes attracting FDI a daunting task, even more so for least developed countries like Nepal.

In recent times, Nepal has made major strides towards reforming its foreign investment regime. The reforms include simplifying the entry mechanism for foreign investors, widening the scope of repatriations and improving the repatriation process, and providing better protection to the investments. Still, there are causes of concern as well, particularly the presence of cumbersome bureaucratic procedure, a more restrictive FDI regime for small and medium sized foreign investments, and inefficient institutions, which make Nepal a less attractive investment destination. Against this background, this article assesses the regulatory and institutional framework currently in place in Nepal to gain insight on whether these are conducive to attracting FDIs considering the new economic reality brought by the COVID-19 pandemic.

FDI inflows in Nepal have historically been low and erratic despite Nepal adopting 'Foreign Investment and One-window Policy, 1992' and implementing 'Foreign Investment and Technology Transfer Act (FITTA), 1992' to promote FDI for building a dynamic economy. Acknowledging the need to reform its FDI policy and regulations, the government of Nepal introduced a new foreign investment policy in 2015 and a new legislation in 2019—FITTA 2019. The new legislation simplified procedures, clarified ambiguities, and addressed foreign investor's issues that were believed to be posing significant hurdles to foreign investors.

First of all, FITTA 2019 simplified the FDI entry system to a certain extent. Until the formulation of FITTA 2019, the mandate of approving foreign investment fell to three different government agencies. FITTA 2019 reduced some complexity by giving the approval mandate to only two agencies—Department of Industry (DoI) for investment up to NPR 6 billion and investment over more than that required approval from the Investment Board of Nepal (IBN). FITTA 2019 also made it mandatory for the investment approval agencies to furnish its decision within seven days of application (FITTA 1992 did not specify any deadline) and required the agency to issue an explanation for rejection (which was not the case before), thus giving clarity to the approval process.

Another improvement was regarding the repatriation of foreign investment and associated incomes. FITTA 2019 expanded the scope of items that would qualify for repatriation by including "compensation from expropriation as well as from indemnity or compensation received as a result of the final resolution of a dispute." Similarly, while previously there was no time limit for approval of repatriation, FITTA 2019 specifies that the request for repatriation be approved by the approval authority (DoI/IBN) within 15 days of the date of receipt of application. Furthermore, FITTA 2019 also made improvements in the treatment and protection of foreign investment by granting national treatment to foreign investors and by assuring protection against both direct and indirect expropriation.

However, despite these reforms, FITTA still lags behind the international standards, hurting Nepal's image as a lucrative investment destination. Facilitating investors will be more essential now as the pandemic is expected to dry up investment in the coming years. For instance, United Nations Commission on Trade and Development (UNCTAD) has estimated that the pandemic could result in cuts in global investment by up to 40 percent during 2020-21 (see Report for more information). The signs of these are already visible in Nepal as reports suggest FDI inflows in Nepal dwindled after the coronavirus outbreak in China.

Quick approval of foreign investment, ease in bringing in the investment, protection of investment, simplified and timely repatriations, and hassle-free administrations underpin a competitive FDI regime. While FITTA 2019 has brought about improvements towards creating a competitive FDI regime, the improvements are somewhat inadequate, more so in the context of current global FDI outlook. For instance, approval mechanism is still cumbersome compared to international best practices. Nepal's current foreign approval mechanism, which requires prior approval from DoI/IBN and a further application to the Nepal Rastra Bank (NRB), is criticized as being unnecessary and excessive since sensitive sectors are already prohibited through a negative list.

Similarly, foreign investors still require multiple approval requirements for foreign exchange facilities and repatriation payments—approval from investment approval agency and NRB, making the whole process unpredictable and full of delays. Likewise, the lack of dispute settlement mechanism between the investor and the State and absence of some foreign investment protection mechanism commonly accorded by international best practices could discourage potential investors. Furthermore, Nepal lacks a central body for investment administration as multiple approvals are required from IBN/DoI and NRB to bring in the foreign investment.

Most important reforms in Nepal's FDI regime will entail simplifying the process for bringing in the foreign investment and for repatriations, as these have been the major concerns of foreign investors. Besides introducing regulatory reforms, a fully functional one stop service center, as provisioned in FITTA 2019, could also be an important step in simplifying FDI entry and other administrations for foreign investors. Some improvements in investment protection such as through provisioning a dispute settlement mechanism, in par with international standards, between foreign investors and the State, will enhance investors' confidence. Furthermore, downward revision of minimum FDI threshold (approximately US$ 414,800 per investor, at present) might also be needed to increase FDI inflows. Moreover, institutions that administer foreign investment need to be capacitated to ensure that the regulatory reforms are implemented and foreign investors receive a hassle-free service. Pending these reforms, diminished FDI inflows will be another addition to economic woes plaguing the country during the difficult times of COVID-19.

This piece is written by Kshitiz Dahal, Research Officer, SAWTEE. Views are personal.

REPORT

Investment prospects turn bleak

Foreign direct investment (FDI) to developing economies in Asia is projected to decline by up to 45 percent in 2020, according to United Nations Conference on Trade and Development's (UNCTAD)World Investment Report 2020.

Global FDI flows are forecast to decrease by up to 40 percent in 2020, from their 2019 value of US$1.54 trillion. This would bring FDI below US$1 trillion for the first time since 2005. FDI is projected to decrease by a further 5 to 10 percent in 2021 and to initiate a recovery in 2022. A rebound in 2022, with FDI reverting to the pre-pandemic underlying trend, is possible, but only at the upper bound of expectations.

FDI flows to South Asia, in 2019, increased by 10 percent to US$57 billion. The rise was driven largely by a 20 percent increase in investment in India, the largest South Asian FDI recipient, to US$51 billion. Most of the investments in India went to information and communication technology (ICT) and construction industries. Flows to Bangladesh fell by 56 percent to about US$2 billion, reflecting an adjustment from a record-high level in 2018. In Pakistan, FDI recovered, growing 28 percent to US$2 billion after a 30 percent fall in 2018.

The outlook for the rest of the year is bleak as lockdown measures and factory stoppages impacted supply chains and factories' production in Asia. Falling corporate earnings, a slump in global and regional demand and economic slowdown have led multinational enterprises to postpone investment plans.

The COVID-19 pandemic underscored the vulnerability of supply chains and the significance of the role of China and other Asian economies as global production hubs.

This year's World Investment Report describes three key technology trends of the new industrial revolution (NIR) that will shape international production: robotics-enabled automation, enhanced supply chain digitalization and additive manufacturing. However, the pace and extent of new technological adoption will partly depend on the policy environment for trade and investment, which is trending towards more interventionism, rising protectionism and a shift to regional and bilateral frameworks. They will also depend on sustainability concerns, including differences between countries and regions on emission targets and environmental, social and governance standards, market-driven changes in products and processes, and supply chain resilience measures.

The effects on international production from the technology, policy and sustainability trends are multi-faceted, and will play out differently across industries and regions, landing in four possible trajectories: reshoring, diversification, regionalization and replication.

The transformation of international production in the post-pandemic era will bring both challenges and opportunities for policymakers. The main challenges in the new era of international production are likely to involve increased divestment, relocations, investment diversion and a shrinking pool of efficiency-seeking investment, implying tougher competition for FDI. Changes in the locational determinants of investment will negatively affect developing countries' ability to attract multi-national enterprise operations. In contrast, new opportunities are likely to arise due to investors looking to diversify supply bases to enhance production resilience.

Shorter value chains leading to distributed manufacturing of final goods and digital platforms can enable new applications and services as well as improve bottom-up access to global value chains. Longer term, supply chain resilience is crucial for economic growth and job creation, and for the development prospects of low-income and vulnerable countries.

Recovery will depend on policymakers safeguarding a trade and investment policy environment favouring a gradual adjustment of international production networks. Governments will face the challenge of dealing with adverse developments but at the same time have plenty of opportunities to capitalize on emerging avenues.

This is excerpted from UNCTAD's World Investment Report 2020.

NEWS

Global economy will take US$12tn hit from coronavirus: IMF

The International Monetary Fund (IMF) has said the global economy will take a US$12 trillion hit from the COVID-19 pandemic after slashing its already gloomy growth projections for the UK and other developed countries in 2020.

The IMF said it would take two years for world output to return to end-2019 levels and warned that governments should be cautious about removing financial support to their fragile economies.

In an update to forecasts published in April, the IMF said it now expected the global economy to contract by 4.9 percent this year, compared with a 3 percent drop expected in the spring of 2020.

The IMF said the coronavirus pandemic had been more negative for activity in the first half of 2020 than expected, and recovery was also projected to be slower. The revised World Economic Outlook said the lockdown had dealt a "catastrophic hit" to the global labour market, adding that rising share prices were out of kilter with the deepest recession of the post-war era.

It said the forecasts were subject to an even greater than usual amount of uncertainty and were based on some key assumptions about the fallout from the pandemic: physical distancing persisting into the second half of 2020, long-term scarring from the larger than anticipated damage caused by the lockdown and a hit to productivity as surviving businesses ramped up workplace safety and hygiene practices.

Source: https://www.theguardian.com/, 24.06.2020.

Trade pacts under lens as India seeks to check Chinese imports

India is looking to plug loopholes in international trading arrangements as it seeks to reduce import dependence on China. The routing of Chinese goods to India through their common trade partners, inversion in duty structures and the exploitation of ambiguities in origin rules have all come under the Indian government's scanner.

India's commerce and industry ministry is putting together details of the installed capacities of local industry for goods that India trades under free trade and bilateral agreements, and products which face issues related to inverted duty structures.

The exercise is to check if these agreements are leading to preferential rates being lower on finished products than the intermediate or raw material.

Especially on the radar are the trade arrangements with South Asian countries under the South Asian Free Trade Area (SAFTA), the Association of Southeast Asian Nations (ASEAN) group, and bilateral pacts with Singapore, Japan, South Korea and Sri Lanka, with a focus to plug gaps that aid imports from China. India suspects China is routing goods through these countries, taking advantage of the trade pacts.

The only operational trade agreement linking India and China — the Asia Pacific Trade Agreement, or APTA, (formerly Bangkok Agreement) — is also under scrutiny. South Korea, Bangladesh, Laos and Sri Lanka are also members of this grouping.

There was a sudden spurt in imports from Singapore, Japan and the ASEAN countries in 2017-18, and inbound shipments have been high since then. India's trade deficit with China was around $47 billion in the first 11 months of fiscal 2020. Industry insiders think that China has been pumping investments in Vietnam and its imports into India are coming unchecked, that too at low duty, through such countries.

On the other hand, China has granted deeper duty cuts to India's competitors including Peru, Pakistan, Australia, South Korea and ASEAN in its FTAs with them, which has displaced some of India's exports.

Source: https://economictimes.indiatimes.com/, 22.06.2020.

China provides tariff exemption for 97 percent of exports from Bangladesh

China has provided a trade boost to Bangladesh by announcing tariff exemption for 97 percent of Bangladeshi products effective from 1 July.

The decision has come one month after Bangladeshi Prime Minister Sheikh Hasina and Chinese President Xi Jinping held a discussion to upgrade their bilateral relations during the COVID-19 pandemic.

The Ministry of Foreign Affairs of Bangladesh announced on 19 June that 97 percent of items would be exempted from Chinese tariffs. Thus, a total of 8,256 Bangladeshi products will come under the 97 percent of products that would be exempted from tariff.

Currently, 3,095 Bangladeshi products enjoy duty-free access to Chinese market under the Asia-Pacific Trade Agreement (APTA). With the new announcement, 97 percent of Bangladeshi products will join this zero-tariff club that raised the number of Bangladeshi products with zero duty access to Chinese market to 8,256.

China's tariff exemption is expected to help Bangladesh cushion the economic impact of the COVID-19 pandemic.

Source: https://economictimes.indiatimes.com/, 20.06.2020.

Bangladesh, Bhutan to sign preferential trade deal

Bangladesh and Bhutan have finalized the terms and conditions for signing a preferential trade agreement (PTA) to increase bilateral trade.

Under PTAs some select goods enjoy duty benefits from both countries whereas under Free Trade Agreement (FTA) almost all do, meaning that, in turn, both countries will also lose import and export revenue.

As per the discussion through a video conference, the officials of both Bangladesh and Bhutan agreed to make the PTA functional from 30 August 2020. The law ministries of both countries are vetting the documents, at present.

Bhutan agreed to provide duty benefit on export of 100 different goods, including garments, processed agricultural goods and electronics. On the other hand, Bangladesh agreed to provide duty benefit to 34 Bhutanese products including fruits.

Trade between Bangladesh and Bhutan that amounted to US$26.52 million in fiscal year 2012-13 reached US$57.90 million in fiscal 2018-19, according to data from the commerce ministry.

Source: https://www.thedailystar.net/, 18.06.2020.

Locusts Invade COVID-Ridden South Asia

Massive swarms of locusts have invaded Pakistan and India just when these South Asian countries are battling the complications of the COVID-19 pandemic.

The locust invasion has the potential to devastate vast, almost unimaginable, acres of agricultural crops. The locusts have already destroyed more than 123,000 acres of crops in India. Pakistan has declared a national emergency.

The mass destruction of fruit and vegetable crops in the region will further diminish access to food for the masses who desperately need to be fed. The crop destruction will further increase the economic stress.

The Indian states of Madhya Pradesh, Uttar Pradesh, Gujarat, Rajasthan and Maharashtra face the potential of being the hardest-hit in this first wave of locusts. These states provide nearly 40 percent of India's agricultural production, equivalent to approximately 80 million tons.

Portions of Pakistan's cotton crop have already been consumed. This will affect the country's dominant textile industry with wage earners losing jobs, disrupting the supply chain from farm to market, and inflated pricing of finished goods as a result of short supply.

Source: https://missionsbox.org/. 15.06.2020.

World Bank's US$450 million road support in Nepal

The World Bank has approved a US$450 million project to help Nepal improve its roads and set the course for post-COVID-19 economic recovery through greater cross-border trade, more jobs, especially for women, and better road safety.

The Nepal Strategic Road Connectivity and Trade Improvement Project will enhance regional road connectivity by improving the Nagdhunga-Naubise-Mugling road and upgrading the Kamala-Dhalkebar-Pathlaiya road. Both are crucial to Nepal's connectivity and trade with India and other countries.

The project will also enhance infrastructure, facilities, and sanitation at border crossing points to ease trade constraints and spur agricultural exports.

Amid the COVID-19 pandemic, the project will also support better screening of goods and people at border facilities, and develop guidance for special working arrangements, such as safe distancing and remote working.

The project is well-aligned with the past and ongoing efforts of Nepal and its regional partners to achieve the full potential for trade in the eastern sub-region of South Asia. It is a part of the World Bank's Eastern Corridor Connectivity Programme, which since 2013, has financed a continually evolving regional programme to improve connectivity and trade in Nepal, Bangladesh, Bhutan and India.

Source: https://thehimalayantimes.com/, 12.06.2020.

Manufacturing output drops sharply in Nepal

Nepal's manufacturing output has dropped sharply as lockdown restrictions slash demand, raising concern among officials and industry leaders.

According to the Ministry of Industry, Commerce and Supplies, essential industries like food, dairy, feed, hatchery and poultry, drinking water and tea are reporting a steep fall in production.

Most of the factories located in the country's five major industrial corridors—Attariya-Dhangadhi, Nepalgunj-Kohalpur, Butwal-Belahiya, Pathlaiya-Birgunj and Itahari-Biratnagar—are operating at below capacity.

The production of factories making biscuits, noodles and snacks shrank from 80 percent of capacity in mid-March to 50-60 percent in the beginning of June.

The output of rice, beaten rice, lintels, flour and oil factories dropped from 75 to 55 percent of capacity during the same period. The ministry said that almost all food industries were in operation currently.

The tea industry, which was operating at 70 percent of capacity in mid-March, is operating at 30-40 percent. The ministry said production declined due to a decrease in demand for Nepali tea in Europe and inability to send samples for testing and certification. Output is down also because the Indian government has stopped the import of Nepali tea, according to a report. India has tightened imports in an effort to prevent the potential spread of Covid-19, he added.

The feed, hatchery and poultry industries also saw a drop in production from 80 percent of capacity to 40 percent. Poultry and hatchery industries are closing down as they have been severely battered by the lockdown. Dairy industries that were running at 80 percent of capacity have slowed down to 60 percent. Local dairies are still in operation, but large enterprises including pasteurisation plants have shut down.

According to the ministry, only 338 of the 597 essential goods factories in 10 industrial areas are in operation. And even those still open are operating at around half their capacity.

And of the 11,736 workers employed by these factories, 4,900 have kept their jobs while 6,836 have been sent home on leave.

Source: https://kathmandupost.com/, 08.06.2020.

PUBLICATION

COVID-19, LDCs and South Asia
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Besides the obvious health-related concerns, the COVID-19 pandemic has left the global economy in tatters. Considering, inter alia, high poverty rates and unequal societies, arrested manufacturing growth, overdependence on agriculture and informal works, and insufficient social protection, least-developed countries (LDCs) and South Asian countries are particularly vulnerable to the economic fallout of the pandemic. The articles in this issue of Trade Insight provide insights into the current situation and responsive mitigation mechanisms adopted by different LDCs and countries in South Asia. As the cover article argues, there are also ways by which LDCs can turn the present crisis into an opportunity. Click here to access the issue.

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