PRIME LAW ASSOCIATES

PROSPECTS OF FDI IN NEPAL

A GUIDEBOOK FOR POTENTIAL INVESTORS BY PRIME LAW ASSOCIATES

PRIME LAW ASSOCIATES

ADVOCATES & LEGAL CONSULTANTS

About Prime Law Associates

Prime Law Associates (PLA) is a dynamic law firm, founded by a group of young and energetic lawyers. PLA has been a successful firm with a good repute among its clients and the legal fraternity in Nepal. Owing to our strong responsiveness to clients need and innovative approach to solve legal issues faced by our clients, we have outstand ourselves as client-centered firm. PLA has already grown into a large full service law firm in Nepal. Our legal team has an excellent combination of professional dynamism and passion for qualify legal service to our clients. Our mission is to provide pragmatic and result-oriented services to our clients at a competitive rate.

The Firm has an office at Anannagar, Kathmandu. We are conveniently located in a close proximity from business and financial hub of Kathmandu where number of government offices and courts are also nearby from our office. PLA has associate law offices throughout Nepal because of referral agreement with number of local law firms in major cities and business centers in Nepal. We have retained a panel of distinguished practitioners who may be available for rendering services in the areas of general legal matters, hydro-power, aviation, foreign Investment, arbitration, taxation, intellectual property, business incorporation, and allied services.

Our lawyers have wide experience in handling wide variety of corporate litigation and transactions matters. We handle various cases in District Courts, Appellate Courts across the country and in the Supreme Court of Nepal. We are very responsive to client's need and legal issues and we always strive to provide excellent legal services to our clients. Client satisfaction is our motto. We offer full service of domestic as well as foreign clients. We establish open and clear communication with client to understand their business need. All cases and transactions are appropriately staffed to ensure efficient and effective handling of the matters. We have highly trained paralegals and support staffs. PLA assist our clients to succeed in their businesses. We understand increasing needs of our clients to tap into international investment and domestic business opportunities.

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Introduction to Foreign Direct Investment

Foreign direct investment (FDI) is defined as an investment reflecting a lasting interest and control by a foreign direct investor, resident in one economy, in an enterprise resident in another economy (foreign affiliate). FDI inflows comprise capital provided by a foreign direct investor to its foreign affiliate resident in the reporting country, or capital received by a foreign direct investor resident in the reporting country from its foreign affiliate abroad. (UNCTAD, 2022c) [1] Foreign direct investment (FDI) occurs when an investor based in one country (the home country) acquires an asset in another country (the host country) with the intent to manage that asset. (WTO 1996) [2] FDI is viewed as a way of increasing the efficiency with which the world's scarce resources are used.

A recent and specific example is the perceived role of FDI in efforts to stimulate economic growth in many of the world's poorest countries. Partly this is because of the expected continued decline in the role of development assistance (on which these countries have traditionally relied heavily), and the resulting search for alternative sources of foreign capital. More importantly, FDI can be a source not just of desperately needed capital, but also of modern technology and intangibles such as organizational and managerial skills, and marketing networks. FDI can also provide a stimulus to competition, innovation, savings, and capital formation, and through these effects, to job creation and economic growth.

Along with major reforms in domestic policies and practices in the poorest countries, this is precisely what is needed to turn-around an otherwise pessimistic outlook.[3] From a WTO perspective, the most interesting and relevant aspect of FDI is its interlinkages- economic, institutional, legal- with world trade.[4]

Why foreign investors should be interested in Nepal?

Nepal has been pursuing a liberal foreign investment policy and striving to create an investment-friendly environment to attract FDI. The Constitution of Nepal recognize the importance of the private sector. Foreign investors are allowed 100% ownership of a company in all sectors and repatriation of capital and profits.

To attract foreign and domestic investment to boost the economy, the Government of Nepal has constituted the high-level Investment Board of Nepal (IBN), chaired by the Prime Minister. The main objective of this board is to facilitate investors in investing in the large-scale potential sectors in Nepal by providing one window facilities.

The largest contributor to Nepal's FDI is India. Indian Companies have made a significant contribution to the Nepalese economy both in terms of employment generation as well as contribution to the National exchequer. The proximity of the Indian market, backed by the Trade treaty offering preferential access free of basis custom duty for Nepalese manufactured goods, coupled with bilateral investment protection and double tax avoidance arrangements with India makes Indian investments in Nepal extremely attractive.

In addition, zero-tariff on products from Least Developed Countries (LDC) like duty free, quota free market access to European Union under Everything But Arms (EBA) arrangements and duty free US market access to 66 types of garment items up to 2026 provides trade free access to Nepalese products in developing and developed countries which makes Nepal attractive as a destination for foreign investment.

Market competition is low and there are low levels of FDI inflows into Nepal. As per the United Nations Conference on Trade and Development (UNCTAD), when it comes to profits, the evidence is that rates of return on foreign direct investment in LDC are much higher than on investment in developed, or even other developing countries. While investing in an LDC can be complex, an LDC is not always riskier than other locations and frequently more profitable.

- The Power Trade Agreement (PTA) signed with India and Bangladesh has opened a large market for export.[7]

- Tax holiday of 100% for first 10 years and 50% for next 5 years.[8]

The trade and treaty with India offer significant and preferential access to the largest market in the South Asia region. Nepal also has duty-free access to the European Union under its Everything-But- Arms initiatives. Implementation of SAFTA has added more space for trade and investment. Our competitive markets for manufacturing and untapped resources and diversified agricultural production base provide myriads of mutually beneficial areas for investment.[9]

Laws Governing Foreign Direct Investment in Nepal

There is recognition within the GoN that foreign investment is necessary to boost economic growth to meet the GoN's target of becoming a middle-income country by 2030. The most significant foreign investment laws are the revised Foreign Investment and Technology Transfer Act (FITTA) of 2019, the Public-Private Partnership and Investment Act (PPIA) of 2019, the Foreign Exchange Regulation Act of 1962, the Immigration Rules of 1994, the Customs Act of 2007 (a revised act is under Parliamentary review), the Industrial Enterprise Act of 2016 (and its 2020 revision), the Special Economic Zone (SEZ) Act of 2016 (and its 2019 amendment), the Company Act (2006), the Electricity Act of 1992, the Privatization Act of 1994, and the Income Tax Act (2002). Also important is the annual budget, released at the end of May every year, which outlines customs, duties, export service charges, sales, airfreight and income taxes, and other excise taxes that affect foreign investment.

The FITTA attempted to create a friendlier environment for foreign investors. It streamlined the process for inbound foreign investment by requiring approval of FDI within seven days of application. Similarly, the FITTA streamlined the profit repatriation approval process, mandating decisions within 15 days. The revised FITTA set up a Single Window Service Center, through which foreign investors can avail themselves of the full range of services provided by the various government entities involved in investment approvals, including the Ministry of Industry, Commerce, and Supplies (MOICS), the Labor and Immigration Departments, and the Central Bank. The FITTA included a provision requiring the government to set a minimum threshold for foreign investment and publish it in the Nepal Gazette. On May 23, 2019, citing that provision, the government raised the minimum foreign investment threshold ten-fold to NPR 50 million (USD385,000) from the existing NPR 5 million (USD38,500). Following lobbying by different bodies, including U.S. Embassy, the GoN reduced this threshold to NPR 20 million (USD154,000) on October 14, 2022. The new FITTA commits to providing "national treatment" to all foreign investors and that foreign companies will not be nationalized. Under the FITTA, investments up to NPR 6 billion (USD46 million) come under the purview, including approval authority, of the MOICS Department of Industry (DOI), and anything above that amount falls under the authority of the Investment Board of Nepal (IBN).

Other relevant laws include the Industrial Enterprise Act, the SEZ Act, an updated Labor Act (2017), and a pending Intellectual Property Rights Act. The Industrial Enterprise Act is intended to promote industrial growth in the private sector, includes a "no work, no pay" provision, and allows companies to take certain steps – such as buying land and establishing a line of credit – while environmental assessments and other regulatory requirements are being conducted. In practice, U.S. and other foreign companies comment that corruption, bureaucracy, inefficient implementation of existing procedures and requirements, and a weak regulatory environment make investing in Nepal a tough proposition.

Another significant piece of legislation that could affect investment decisions in Nepal is the Customs Act (2007), which established invoice-based customs valuations and replaced many investment tax incentives with a lower, uniform rate. In 2017, the Department of Customs started to use the Automated System for Customs Data (ASYCUDA) world software platform. In addition, the Electricity Act includes specific terms and conditions for investment in hydropower development and the Privatization Act of 1994 authorizes and defines the procedures for privatization of state-owned enterprises.

There is no public evidence of direct executive interference in the court system that could affect foreign investors. However, in recent years there has been public and media criticism of the politicization of the judiciary, including appointments of judges to Appellate Courts and the Supreme Court allegedly based on their political affiliations.

The IBN, a high-level government body chaired by the Prime Minister, was formed in 2011 to promote economic development in Nepal. In addition to approving large-scale investment projects, the IBN is also the GoN body charged with assessing and managing public-private partnership (PPP) projects. It has the task of attracting large foreign investors to Nepal and was a key organizer of the last two Investment Summits in 2017 and 2019. It is the primary point of contact for large investors (above USD46 million), especially those engaged in public infrastructure projects.

The Nepal Business Forum was formed in 2010 with the "aim of improving the business environment in Nepal through better interaction between the business community and government officials." The NBF does not meet according to a regularized schedule, and the Embassy is not aware of any formal mechanisms or platforms to enable on-going dialogue, aside from the IBN, DOI, and the NBF. Local business associations such as the Federation of Nepali Chamber of Commerce and Industry (FNCCI) and others have constant on-going dialogue with the GoN, representing the private sectors views and requests for policy reforms.

The sectors excluded from foreign investment are listed in the annex of the FITTA 2019 and include:

a. Primary agricultural sectors including animal husbandry, fisheries, beekeeping, oil-processing (from seeds or legumes), milk-based product processing; (Note: The GoN is attempting to open this sector for FDI if 75 percent of the products are exported. However, the matter is under review at the Supreme Court.)
b. Small and cottage enterprises.
c. Personal business services (haircutting, tailoring, driving, etc.).
d. Arms and ammunition, bullets, gunpowder and explosives, nuclear, chemical, and biological weapons, industries related to atomic energy and radioactive materials.
e. Real estate (excluding construction industries), retail business, domestic courier services, catering services, money exchange and remittance services.

f. Tourism-related services – trekking, mountaineering and travel agents, tourist guides, rural tourism including arranging homestays.
g. Mass media (print, radio, television, and online news), feature films in national languages.
h. Management, accounting, engineering, legal consultancy services, language, music, and computer training; and
i. Any consultancy services in which foreign investment is above 51 percent.

Investment proposals are screened by the DOI or the IBN to ensure compliance with the FITTA and other relevant laws. Historically, the lack of clear, objective criteria and timeframes for decisions have resulted in complaints from prospective investors. While the GoN intended the FITTA to address these issues, the regulations enabling the implementation of the Act were only completed in January 2021, and anecdotal evidence suggests services to prospective investors through the One Window Service Center at the DOI are slowly improving.

Status of Foreign Direct Investment in Nepal

Foreign direct investment is especially important now for an import dependent Nepal with a widening trade deficit, and declining foreign reserves. Creating a facilitating environment for FDI is important to promote and encourage production within the country.[10]

- FDI vital for capital formation and investible resources for Nepal, but its significance cannot be ignored for the transfer of technology, skills and managerial as well as organizational practices it brings along.[11]

- Foreign Direct Investment (FDI) plays a significant role in the economic development of developing countries. In addition to capital formation, FDI is driven by investors aiming to make long-term profits through the transfer of technology, management expertise and access to global markets. Nepal has adopted liberal economic policies with several incentives to establish an investment-friendly environment to attract FDIs into the economy.[12]

- The survey shows that the stock of FDI in Nepal increased by 16 percent to Rs.264.3 billion at the end of 2021/22. Paid-up capital is the major component in FDI stock as it accounts for 53.7 percent of total FDI stock whereas the reserves and loans in total FDI stock accounts for 31.7 percent and 14.6 percent, respectively.[13]

- Nepal has received foreign investment from fifty-seven different countries as of mid-July 2022. In terms of total FDI stock, India ranks top position with Rs.88.6 billion followed by China (Rs.33.4 billion), Ireland (Rs.20.9 billion), Singapore (Rs.16.1 billion), and Saint Kitts and Nevis (Rs.15.1 billion).[14]

- Industrial sector accounts for 62.6 percent of total FDI stock. Of which, electricity, gas, steam, and air conditioning sector constitutes 32.8 percent and manufacturing sector 29.5 percent of total FDI stock.[15]

- About 37.3 percent of total FDI stock is in the service sector. Of which, financial and insurance services sector constitutes 25.6 percent, accommodation and food services sector 5.3 percent, and information and communication sector 4.8 percent of the total FDI stock.[16]

- The electricity, gas, steam, and air conditioning sector, particularly hydropower sector, in Nepal has been a preferred sector for FDI in recent years. The latest survey shows that 32.8 percent of FDI stock and 41.8 percent of total paid-up capital are in this sector. Moreover, hydropower sector has also attracted other sources of external financing such as foreign loans in addition to FDI; the electricity, gas, steam, and air conditioning sector accounts for 41.4 percent outstanding foreign loan at the end of 2021/22.[17]

- The capacity utilization of FDI based manufacturing companies stands at 71.1 percent, while the profitability of FDI companies remains at 14.3 percent in the review year.[18]

As per the Survey Report on Foreign Direct Investment in Nepal (2021/22) published by Nepal Rastra Bank, the stock of FDI in Nepal increased by 16 percent to Rs. 264.3 billion at the end of 2021/22. Paid up capital is the major component in FDI stock as accounts for 53.7 percent of total FDI stock whereas the reserves and loans in total FDI stock account for 31.7 percent and 14.6 percent, respectively.

According to the World Investment Report 2023 published by the United Nations Conference on Trade and Development, FDI flows to many smaller developing countries are stagnant, while flows to the LDCs fell by 16 percent to $22 billion, equivalent to less than 2 percent of the global FDI.[19] However, the positive report of NRB's survey suggests that Nepal has the potential to bring in more FDIs.

FDI Stock by Major Countries [20]

Rs. Million

S.N.	Country	As of Mid-July 2022,				Share in Total FDI Stock (%)
		Paid-up Capital	Reserves	Loan	FDI Stock	
1.	India	53,395.2	31,535.9	3,661.5	88,592.6	33.5
2.	China	24,341.2	-8,718.2	17,825.6	33,448.6	12.7
3.	Ireland	9,010.3	11,886.3	0.1	20,896.7	7.9
4.	Singapore	5,388.4	10,332.7	352.9	16,074.0	6.1
5.	Saint Kitts and Nevis	80.0	15,010.4	1.1	15,091.5	5.7
6.	Australia	8,912.9	4,238.9	4.0	13,155.9	5.0
7.	South Korea	10,529.1	-1,061.1	3,304.1	12,772.0	4.8
8.	United Arab Emirates	830.9	9,342.3	473.5	10,646.7	4.0
9.	United States of America	2,591.3	3,727.0	2,096.5	8,414.8	3.2
10.	Netherlands	3,089.9	3,189.6	45.6	6,334.0	2.4
11	Others	23,784.2	4,302.3	10,816.0	38,902.6	14.7
	Total	**141,962.5**	**83,786.1**	**35,581.0**	**264,329.5**	**100.0**

Nepal has received foreign investment from fifty-seven different countries as of mid-July 2022. Country-wise, India is in the top position with Rs. 88.6 billion FDI followed by China (Rs. 33.4 billion), Ireland (Rs. 20.9 billion), Singapore (Rs. 16.1 billion) and saint Kitts and Nevis (Rs. 15.1 billion). The majority of India's FDI stock (96.9 percent) is concentrated in three sectors- electricity, gas, steam, and air conditioning (42.9 percent), manufacturing (35.9 percent), and financial and insurance services (18.1 percent). In terms of paid-up capital, the investment in electricity, gas, steam, and air conditioning, primarily the hydropower sector remains the highest.[21]

- The Department of Industry classifies FDI approved by Nepal into Agro Forestry, Information Technology, Manufacturing, Service, Energy and Tourism.

Industries Approved for FDI by Category

(Up to FY 2078/079) [22]

Category	No. of Projects	Total Project Cost	Total Fixed Cost	Total Working Capital	Total Amount of Foreign Investment	No. of Employment
Agro and Forestry Based	295	10,009.82	7,933.84	2,075.98	8,188.23	10,846
Energy Based	91	222,938.50	218,770.71	6,067.79	130,404.08	11,890
Information Technology Based	120	15,215.48	12,745.62	2,469.86	11,987.38	6,321
Infrastructure	54	5,566.34	4,101.28	1,460.53	4,707.01	3,824
Manufacturing	1,264	130,938.43	100,681.81	100,681.81	69,227.56	106,568
Mineral	72	10,366.92	8,235.80	8,235.80	7,981.01	8,786
Service	1,821	123,969.14	70,837.40	70,837.40	95,914.32	78,124
Tourism	1,816	109,229.95	94,801.26	94,801.26	90,607.38	65,544
Total	**5,533**	**628,497.08**	**518,308.22**	**518,308.22**	**419,269.47**	**292,120**

FDI Stock by Major Sectors [23]

S.N.	Sectors	As of Mid- July,				Percent Change (%)	
		2020	2021	2022		2020/21	2021/22
				Amount	Share in Total (%)		
1	Electricity, gas, steam, and air conditioning	54,660.9	70,147.30	86,815.00	32.80	28.3	23.80
2	Manufacturing	56,066.8	67,352.00	77,928.70	29.50	20.1	15.70
3	Financial and Insurance Services	54,288.4	61,399.50	67,780.50	25.60	13.1	10.40
4	Accommodation and food services	11,846.4	12,975.90	13,884.10	5.30	9.5	7.00
5	Information and Communication	12,618.5	10,858.20	12,733.00	4.80	-14.0	17.30
6	Education	1,877.0	1,926.40	2,074.70	0.80	2.60	7.70
7	Human Health and Social Work	365.2	338.90	735.40	0.30	-7.20	117.00
8	Construction	470.1	492.00	660.90	0.30	4.70	34.30

9	Agriculture, Forestry and Fishing	220.5	240.90	267.90	0.10	9.20	11.20
10	Mining and Quarrying	-1.20	-2.90	36.10	0.01	141.90	-
11	Transport and Storage	-2,772.20	-6,515.90	-7,678.80	-2.90	135.00	17.80
12	Other	8,880.40	8,734.70	9,092.10	3.40	-1.60	4.10
	Total	**198,520.80**	**227,329.50**	**264,329.50**	**100.00**	**14.80**	**16.00**

Electricity, gas, steam, and air conditioning sector has the highest FDI stock of Rs. 86.8 billion (32.8 percent of the total) followed by the manufacturing sector (Rs. 77.9 billion) and financial and insurance services (Rs. 67.8 billion).[24] FDI stock of transport and storage decreased because of the significant decline in the reserve position of the companies within the sector.

The Prospects and the Dilemmas

(A) Political and Legal System in Nepal

The government has introduced policies to welcome and protect foreign investment in Nepal. The country has enacted the Foreign Investment Policy, 2014 to safeguard the rights of investors and define the facilities that have been provided. Nepal currently has an open liberalized market that allows for foreign investment in a wide range of sectors. Nepal is also a member of the World Trade Organization and member countries can exercise the concessions facilitated.

The geographical location of Nepal allows for a budding area for investment- the country is situated between India and China and has evolved as a hub for development in recent years. The country also has statutory protection for investments in place entailing that all investment is protected. Investors also exercise rights against nationalization of their investment and property. They also have a right to cent percent repatriation of their investment profits, making Nepal an arable platform for investment.

An important prerequisite for a prominent level of FDI is that investors view the political risk of the host country as manageable. Political risk may, for example, comprise the danger of expropriation of the investment without adequate compensation, or subtler regulatory measures with comparable effects, which are often referred to as indirect expropriation. The most important legal instruments in international investment law that may mitigate this kind of risk are bilateral investment treaties (BITs). Since the first BIT, concluded between Germany and Pakistan in 1959, the number of such treaties has risen to the impressive number of more than 2700 in 2010.[25]

The 2022 Corruption Perceptions Index reported by Transparency International ranked Nepal as the 110th least corrupt country among 180 countries in the world. Apart from persistent corruption, another reason potential investors are staying away from Nepal is the endless hassles they must face. Recent example of the frustrated investors is the Tiger Palace Resort in Bhairahawa, a Rs.6 billion five-star integrated casino resort owned by an Australian-based company that encountered so many issues that it closed business after only five years of opening. Similarly, multinational Amul brand has been unable to enter Nepali market as all its efforts have been thwarted by the dairy lobby numerous times. Although, the global recession has also slowed down the incoming FDI, there are other elements at hand which have continually deterred investors from investing in Nepal.

(B) Economic System

Nepal has a mixed economic system with aspects of both capitalism and socialism. The country has a Privatization Act, 1993 and has adopted and consistently pursued a liberalization policy since 1990 with the aim of engaging the private sector in new areas of trade and business. The preliminary estimate of economic growth for ……………………..

FDI constitutes the largest source of external finance for developing countries.[26] However, FDI is prone to risk. In addition to the operational risk inherent in any business activity, FDI suffers from political risk. Investors need to be concerned with the protection of their investment from expropriation, be it direct or indirect, and any other derogation of their assets by governmental actions. Several institutions on both the domestic and international level have developed to mitigate this kind of risk. The most important development in international law in this regard is the emergence of Bilateral Investment Treaties (BITs). While the number of these treaties has been steadily growing since the first treaty in 1959, the number of arbitrations based on BITs and the controversies surrounding the content and impact of BITs has been notably increasing in the last decade.[27]

Developing a better understanding of the legal structure surrounding the protection of FDI is an important enterprise, especially because FDI can contribute to the economic development of poor countries. The legal protection of FDI does not only have important implications regarding the integration of the global economy, but also about issues of domestic public policy as BITs limit the sovereignty of governments.[28]

(C) International regulatory considerations

Nepal is one of the eight members of the South Asian Association for Regional Co-operation (SAARC). Under SAARC, Nepal is also a member of the South Asian Free Trade Area (SAFTA) which came into force on January 1, 2006, with the goal of creating a duty-free trade regime among SAARC member countries. According to SAFTA rules, member countries were supposed to reduce formal tariff rates to zero by 2016. However, tariff barriers remain in place for hundreds of “sensitive” goods produced by various SAARC member countries that do not qualify for duty-free status.

Nepal is also a member of the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), an international organization of seven South Asian and Southeast Asian nations: Bangladesh, India, Myanmar, Sri Lanka, Thailand, Bhutan, and Nepal. Bangladesh, Bhutan, India, and Nepal – known collectively as BBIN – are working together to develop a platform for sub-regional cooperation in such areas as water resources management, power connectivity, transportation, and infrastructure development. The four BBIN nations agreed on a motor vehicle agreement (MVA – both cargo and passengers) in 2015. In early 2018, Bangladesh, India, and Nepal also agreed on operating procedures for the movement of passenger vehicles, and in early 2020, the same three countries met to draft a memorandum of understanding to implement the MVA, without obligation to Bhutan.

Nepal's regulatory system relies on international norms and standards developed by the United Nations, World Bank, World Trade Organization (WTO), and other international organizations and regulatory agencies.

(D) Business prospects

Nepal is ranked ninety-four among 190 economies in the ease of doing business, according to the latest World Bank annual ratings. The rank of Nepal improved to 94 in 2019 from 110 in 2018.[29]

Nepal's annual Gross Domestic Product (GDP) is USD36.3 billion, and trade totaling USD15.9 billion. Despite considerable potential – particularly in the energy, tourism, information, and communication technology (ICT), infrastructure and agriculture sectors – political instability, widespread corruption, cumbersome bureaucracy, and inconsistent implementation of laws and regulations have deterred potential investment. While the Government of Nepal (GoN) explicitly states its keenness to attract foreign investment, this has yet to translate into meaningful practice. The COVID pandemic coupled with a fresh bout of political instability slowed reform efforts that might have made Nepal a more attractive investment destination. Despite these challenges, foreign direct investment (FDI) into the country has been increasing in recent years. Historically, few American companies have invested in Nepal; and yet the U.S. still features among the top ten foreign investors in Nepal, constituting about 2.9% of the total FDI stock.[30]

The business prospects can be discussed based on the existing investment opportunities as discussed further and the challenges posed therein with such investments.

(a) Hydropower:

One of the most attractive investment sectors in Nepal is that of hydropower. Being the second largest source of hydropower in the world, Nepal has the potentiality of generating 83,000 MW of hydropower. A land of over 6,000 rivers and streams with a combined length of more than 45,000 km. Nepal has many hydropower projects currently at hand, many of them are economically lucrative. It is high time to invest in Nepal in hydropower sector that ensures sustained and reliable availability of energy to the domestic market as well as for export to neighboring India.

With Nepal being self-sufficient on electricity and with newer prospects of exporting electricity to India and Bangladesh, the interest in hydropower has been soaring in public as well, as seen from the overwhelming application for IPOs from the public. Acting on this demand with proper EIA reports and sufficient FDIs will open ways for profitable businesses in hydropower.

However, given the terrains of Nepal, Nepal is prone to natural disasters in the monsoon, including flood and landslides, which threaten hydropower companies. For instance, this year hydropower sector incurred losses amounting to Rs 8.4 billion in flooding and landslides in Eastern districts on June 16-17.[31] Therefore, a risk assessment report must be prepared and presented to the potential investors before bringing in the FDI. This has two benefits. First, the investors are aware of the type of investment that they are making, and the risks involved thereof. Second, the foreign investors will have access to advanced technologies and project implementation ideas that will help mitigate such risks- which is one of the most impressive and important aspects of bringing in FDIs, as FDIs not only bring capital but innovative ideas and technology that are new to a LDC like Nepal.

(b) Tourism:

With the world's highest mountain range, the Himalayas, and eight of the ten highest peaks in world, popular among mountaineers, trekkers, and adventure seekers. Nepal offers beautiful lakes, steep rivers and gorges, unique wildlife, historic monuments, impressive fine arts, significant religious sites, and exotic cultures attracting a wide array of travelers for a variety of reasons. It is a destination for religious tourism and pilgrimages. Lumbini, the birthplace of Lord Buddha, and Pashupatinath and other Hindu pilgrimage sites are the main attractions for people following Buddhism and Hinduism. Opportunities in developing tourism infrastructure (hotels, restaurants, roads, airports, cable car etc.). Also, enormous potential for expanding the market for meetings, international conferences, and events.[32]

(c) Information and Communication Technology:

One of the fastest emerging sectors in the country, with immense potential for growth in the coming years. All areas open to foreign direct investment except for media. For telecommunications, 80% foreign ownership is allowed. The Government has identified IT and business process outsourcing (BPO) as one of the five priority potential export service sectors. Only two major telecommunications companies (NTC and NCell) dominate the sector, providing ample room for new firms to enter the market. Foreign BPO companies can tap into the young English-speaking population and benefit from the cost advantages offered by the low wages and low establishment and operating costs. The time zone favorable for companies looking to outsource from America or Europe. Unmet needs for the use of ICTs in governmental agencies and the private sector. Long Himalayan range and cold climate in the surrounding area presents opportunities for establishing data mining/warehouse industries in Nepal.[33]

(d) Geopolitics:

India refusing to invest or work with any field or department that involves Chinese investment. The investors' country of origin also has an impact on whether the investment will be able to yield productivity as ties between nations directly influence the business world. **MCC Internal Political ideologies**

(e) Financial Sector:

Financial sector of Nepal still has a large untapped market for banking and financial services. Nepal's Insurance market has also immense potential as the penetration rate is about 20%. **Various chambers of commerce: NICCI, FNCCI**

Pursuing new trade deals through Free Trade Agreements, Preferential Trade Agreements and Regional Trade Agreements is the best way forward, irrespective of the potential trade and tariff costs. In this regard, Bangladesh is an exemplary model. Their list of concluded and ongoing negotiations for Free Trade Agreements and Preferential Trade Agreements includes twenty-three countries and three regional alliances. Nepal should not delay in learning from its experience.

Similarly, the cost of being landlocked can be reduced through better trade facilitation to alleviate the impact of eliminated preferences. Addressing various supply-side constraints through trade capacity building requires greater attention. Lastly, revamping the investment climate should be the highest agenda without compromise.[34]

(f) Graduation from LDC to a developing country:[35]

Nepal is scheduled to graduate from least developed country to a developing country on 24 November 2026.[36] The 40th plenary of the 76th Session of the United Nations General Assembly (UNGA) in November 2021 had unanimously adopted a resolution, endorsing Nepal's graduation from the LDC category with the preparatory period of five years.[37] Nepal has been an LDC since its listing in the group in 1971.

As per the "Nepal Human Development Report 2020: Beyond LDC Graduation", graduation from LDC makes countries more creditworthy in the eyes of international credit rating agencies, thus improving access to commercial finance.

Nepal's graduation from the LDC category: Implications for international trade and development cooperation, SAWTEE (2022) (report): LDCs have been given four major flexibilities and special and differential treatment in the implementation of the WTO's Agreement on Trade-Related Aspects of Intellectual Rights (TRIPS). **First,** the General transition period where LDCs have been provided with a general transition period, originally provided for 11 years by Article 66.1 of the TRIPS Agreement and subsequently extended several times.[38] **Second** is the specific transition period for pharmaceutical products, whereby as an LDC Nepal is exempted from protecting patents and undisclosed information for pharmaceutical products until 1 January 2033.[39] The **third (**Access to medicines through imports**)** type of flexibility, in the implementation of the TRIPS Agreement that Nepal is entitled to as an LDC concerns a special system of compulsory licensing aimed at addressing public health needs.[40] **Fourth,** Technology transfer, The fourth type of special treatment accorded to an LDC under the TRIPS Agreement is under Article 66.2, which obliges developed country members to provide incentives to enterprises and institutions in their territories to promote technology transfer to LDCs. [41]

The case studies of three of the countries that have graduated from the LDC category: Botswana, Maldives, and Vanuatu, shows that each of these countries achieved graduation with the aid of different strategies formulated and implemented in pursuit of development goals. None of these graduating countries specifically focused on graduation as a goal or destination but considered graduation to be a milestone in their developmental path. Botswana tapped into its minerals resources for development, the Maldives focused on developing the tourism sector and Vanuatu promoted exports of kava, copra and coconut oil.[42] The lesson other soon-to-be graduating countries can learn from Vanuatu's graduation, graduation strategy and transition strategy is to have a clear action plan aimed at achieving the larger goals of national policies and strategies.[43] Foreign direct investment has also been on an increasing trend since Botswana's graduation in 1994. This indicates that Botswana was able to create a business-friendly environment to attract FDI after graduation.[44]

Also, graduation from the LDC category would transmit a positive message to the global community about Nepal's development prospects. It can be branded as a potentially competitive destination for foreign direct investment inflows and other private investments.

For Nepal, the biggest fear after graduation is seeing its export trade being limited to India once LDC preferences are removed. Its trade diversification effort becomes more challenging because of potential shrinkages in export markets. The end of non-reciprocal preferences received through the Generalized System of Preferences in several countries is a crucial factor. The European Union's "Everything but Arms" scheme is a prominent example, which extends duty-free access to all Nepali products. Furthermore, the LDC provisions in exports extended by the South Asian Free Trade Area will be removed. The LDC requirement for Rules of Origin is another example.[45]

Additionally, Nepal may come under surmountable pressure to rationalize its sensitive list as it has a longer list.[46] Similarly, Nepal will lose LDC exemptions from some obligations, such as patents in pharmaceutical industries granted by the World Trade Organization Agreement on Trade-related Aspects of Intellectual Property Rights (TRIPS).[47] This could lead to more expensive products. However, the list of losses does not end there; exporting will become more difficult.[48]

(g) Manufacturing/ Issues in prioritizing products of global potential:

The Nepalese industries have not been able to prioritize the changing needs of the global market. For instance, the government has dropped the jut industry form its priority list even though global demand for ecological packaging has strengthened its export potential.[49] Till three decades ago, Nepal was a major jute exporter to Europe. The crop was one of the major sources of foreign exchange. Explain a little more.

(h) Settlement of Disputes:

The dispute may be resolved through mutual consultation, and if required, the Department of Industry may facilitate resolving the dispute. • If the dispute cannot be resolved with mutual consultation, then the dispute shall be resolved as per the parties' written agreement • If the parties' agreement is silent, then dispute shall be resolved by arbitration. Unless otherwise agreed to by the parties, the arbitration proceedings shall be in accordance with UNCITRAL Rules, the arbitration will be governed by substantive laws of Nepal and venue will be in Nepal. • The new FITTA provides the freedom to parties to enter into an agreement for settlement of dispute. This means that investment agreements can be governed by foreign law and any dispute under such agreement can be submitted to the foreign courts or arbitration with some limitation for enforcement of arbitral award. • Even though the new FITTA provides freedom to parties to enter into an agreement for dispute settlement, there two important concerns: a. According the Arbitration Act, 1998 of Nepal a foreign arbitral award can enforced in Nepal only if (A) Nepal is party to a treaty related to enforcement of foreign arbitral award, and (B) the award is rendered in the territory of the party to that treaty subject to the conditions set out at the time of being party to that treaty itself. Also, it is also essential that the dispute between the party's amount to commercial dispute under laws of Nepal as well as there needs to be reciprocity between Nepal and the foreign country for enforcement of foreign arbitral award. Beside that the Mutual Legal Assistance Act, 2014 is also vital and should consider a principal legislation governing enforcement of Foreign Judgment in Nepal. As per the provisions of this act it is mandatory to have bilateral.[50]

In 2019, a Malaysian company, Axiata (owner of Ncell, the largest private telecom company in Nepal), was made to pay $450 million for alleged tax evasion over the 2016 transfer of Ncell's ownership from its previous owners, Swedish firm Telia Sonera. The Supreme Court's verdict on this case has set the precedent for placing buyers on the hook for the tax liabilities of the sellers. Axiata has taken the matter to the International Center for Settlement of Investment Disputes (ICSID), which is still deliberating on the case.

(i) Repatriation:

The FITTA allows foreign investors to repatriate all profits and dividends, all money raised through the sale of shares, all payments of principal and interest on any foreign loans, and any amounts invested in transferring foreign technology. Doing so, however, requires multiple approvals and extended procedures which have historically resulted in such transactions taking months to complete. Foreign nationals working in local industries are also allowed to repatriate 75 percent of their income. Opening bank accounts and obtaining permission for remittance of foreign exchange are available based on the recommendation of the DOI, which usually has provided approval of the original investment.

In practice, repatriation is difficult, time consuming, and not guaranteed. The relevant GoN department and the NRB, which regulates foreign exchange, must both approve the repatriation of funds. In most cases, approval must also be obtained from the DOI. In the case of the telecommunications sector, the Nepal Telecommunications Authority must also approve the repatriation. In joint venture cases, the NRB and the Ministry of Finance must grant approval. Repatriation of funds is expected to become easier after the single window service center, as provided for by the FITTA, comes fully into operation.

Foreign investor is entitled to repatriate the following amount outside Nepal in the currency as set out in the agreement:

• The amount received by the sale of the share of foreign investment as a whole or any part thereof. • The amount earned from profit or dividend.

• The amount received from the outstanding amount after liquidation of a Company or an Industry and after the payment of liabilities.

• The amount received as a Royalty under the Technology Transfer Agreement.

• The amount received from the Lease Rent.

• Compensation granted by tribunal after end of litigation, arbitration, or other legal procedure.

• Other amount that can be repatriated under prevailing law.[51]

(j) Trade policies

Trade policies can affect the incentives for FDI in many ways. A sufficiently high tariff may induce tariff jumping FDI to serve the local market. Other types of import barriers can have the same effect, of course. It is no coincidence that Japanese automobile manufacturers began producing in the European Union and the United States following the imposition of so-called "voluntary export restraint" agreements (VERs) limiting the number of automobiles that could be shipped from Japan. FDI may also be undertaken for the purpose of defusing a protectionist threat. Such quid pro quo investments are motivated by the belief that the added cost of producing in the foreign market is more than compensated for by the reduced probability of being subjected to new import barriers on existing exports to that market. There is evidence, for example, that the perceived threat of protection had a substantial impact on Japanese FDI in the United States in the 1980s, and that these investments reduced the subsequent risk of being subjected to contingent protection resulting from anti-dumping and escape clause actions.[52]

The trade and treaty with India offer significant and preferential access to the largest market in the South Asia region. Nepal also has duty-free access to the European Union under its Everything-But- Arms initiatives. Implementation of SAFTA has added more space for trade and investment. Our competitive markets for manufacturing and untapped resources and diversified agricultural production base provide myriads of mutually beneficial areas for investment.[53]

The major dilemmas in FDI are:

· Corruption, laws limiting the operations of foreign banks, lingering challenges in the repatriation of profits, controlled currency exchange facilities, prohibition of FDI in certain sectors as well as a minimum foreign investment threshold of NPR 20 million (USD154,000), and the government's monopoly over certain sectors of the economy (such as electricity transmission and petroleum distribution), undermine foreign investment in Nepal. Political uncertainty is a continuing challenge for foreign (as well as domestic) investors. Nepal's ruling parties have spent much of their energy over the last years on internal political power struggles instead of governance. While fresh elections in November 2022, and a new government has raised hopes for political stability, this is not guaranteed. Political instability often engenders policy stagnation and uncertainty.

· A lack of understanding of international business standards and practices among the political and bureaucratic class, and a legal and regulatory regime that is not aligned with international practices also impede, hinder, and frustrate foreign investors. Elements of Nepal's tax regime may be inconsistent with international practices and could trip-up foreign investors as has happened in two cases in recent years.

· Millions of Nepalis seek employment overseas, creating a talent drain, especially among educated youth.

· Immigration laws and visa policies for foreign workers are cumbersome. Inefficient government bureaucratic processes, a high rate of turnover among civil servants, and corruption exacerbate the difficulties for foreigners seeking to work in Nepal.

· Nepal's geography also presents challenges. The country's mountainous terrain, land-locked geography, and poor transportation infrastructure increases costs for raw materials and exports of finished goods.

· Trade unions—each typically affiliated with parties or even factions within a political party—and unpredictable general strikes can create business risk, although this problem, once common, has diminished in recent years.

· The potential use of intimidation, extortion, and violence – including the use of improvised explosive devices – by insurgent groups targeting domestic political leaders, GoN entities, and businesses remains a source of potential instability, although this threat too has diminished in recent years (the country's most prominent insurgent group—led by Netra Bikram Chand, also known as Biplav—agreed in March 2021, to enter peaceful politics, for example.)

Conclusion

Foreign Direct Investment (FDI) plays a catalytic role in economic growth. It is a source of capital formation. Likewise, it helps technology to spillover, supports human capital formation, enhances international trade integration, creates a competitive environment, and strengthens enterprise development.[54] An all-out effort to assure the country's preparedness is still unseen in Nepal. For a smooth transition, a comprehensive strategy is absent but utterly needed. Policy conflicts paralyzing its prospects of implementation should end. Graduating from the LDC status is a significant achievement, but this is no time to gloat. The question remains whether the benefits outweigh the losses.

It is imminent that we segregate the scopes of foreign direct investments in Nepal, so that the potential investment areas do not remain closeted due to confusion.... Ensuring this is a complex and tenacious task, it needs a balance between flexibility, comprehensiveness and costs before intricate planning and execution. Therefore, a one window policy for proper implementation of laws, procedures and the scheme need to be weaved with caution, relying on extensive field research, established facts and with strategies that will bear desired result. Overall, as is the trend in Nepal, resources expended for developing such plans and policies should not go in vain due to lack of thorough study and feasibility analysis.

To realize the vast untapped export potential, the government should prepare trade strategies, in consultation with the private sector, to strengthen the overall competitiveness of the economy, upgrade exporters' capabilities, diversify export products and markets, simplify and streamline processes to attract more foreign direct investment and encourage enterprises to participate in regional/global value chains. Such strategic policies may also help compensate for the loss of LDC-specific international support measures.

Foreign investment in Nepal is open in multiple sectors and size of industries- investments in both small scale and large-scale industries have been welcomed in the country. Given Nepal's geographical prowess, sectors such as energy and tourism have seen a maximization of potential investment in a competitive environment. The government has also aided this by making foreign investment a priority sector.

The World Bank estimates Nepal's untapped export potential at around US$9.2 billion— 12 times its actual annual merchandise exports (World Bank, 2021). To realize the potential, the government should prepare trade strategies, in consultation with the private sector, to strengthen the overall competitiveness of the economy, upgrade exporter's capabilities, diversify export products and markets, simplify and streamline processes to attract more foreign direct investment and encourage enterprises to participate in regional/global value chains. Such strategic policies may also help compensate for the loss of LDC-specific ISMs.

Talking about the problems without talking about some accessible solutions is the way to paralysis rather than progress. Amartya Sen, the economist-philosopher, and Nobel Prize Laureate, says that poverty leads to an intolerable waste of talent. Similarly, poverty is not just a lack of money; it is not having the capability to realize one's full potential.[55] Likewise, Nepal has plenty of resources and has the attention of foreign investors to invest in numerous sectors that have been made viable through the liberal investment policies of the government, backed by the Constitution. Apparently, Nepal lacks the capability to prowess the numerous sectors viable for foreign investment and cash in the FDIs because Nepal cannot ensure stability, be it in politics or the economy- where misinformation and insufficient knowledge of policies and the FDIs are directly considered as threat to national security and sovereignty depending upon the ruling party's political incline as was evident during the ratification of MCC. However, experts are always to be consulted in these complex situations rather than going with the flow of public opinions because public opinions are formed based on limited information, whereas experts derive a conclusive answer to the complexities.

To consult or get legal advice from our expert Foreign Direct Investment Lawyers in Nepal; Contact us at 977-01-4102849/ +9779851059026, Prime Law Associates, Anamnagar, Kathmandu, info@primelawnepal.com, www.primelawnepal.com

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