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Foreign Investment Climate In Nepal

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INTRODUCTION

Present economic scenario of Nepal is not of so much encouraging. Economic Survey Report 1996/97 reports that the Gross Domestic Product (GDP), at factor cost, in Fiscal Year, 1984/85 prices grew by 4.9 percent in FY 1996/97, where as GDP grew by 6.1 percent in 1995/96. The decline in the growth rate of GDP during the FY 1996/97 compared to the previous FY 1995/96 was mainly due to the decline in the growth rate of agricultural and non-agricultural sectors. Among the nine sectors contributing to GDP, all the major sectors except manufacturing, electricity, gas and water experienced slower growth rate in FY 1996/97 than that of previous Fiscal Year 1995/96. Therefore, it is estimated that the growth rates of agricultural and non-agricultural sectors would be 3.3 percent and 6.1 percent respectively in FY 1996/97 compared to 5.4 percent and 6.7 growth rate in FY 1995/96. The contribution of different economic sectors to GDP at constant prices of 1984/85 in 1995/96 and 1996/97 is explained in Table 1.

Table No. 1

Contribution Of Different Sectors To GDP Of Nepal

(In Million NRs)

Description	FY 1995/96		FY 1996/97	
	Amount	Percent	Amount	Percent
Agriculture, Fisheries and Forestry	315335	41.44	32566	40.78
Mining and Quarrying	343	0.45	357	0.45
Manufacturing	6328	8.32	7089	8.88
Electricity, Gas and Water	522	0.68	563	0.70
Construction	7336	9.64	7591	11.74
Trade, Restaurant and Hotel	8833	11.61	9379	11.74
Transport, Communiaction and Storage	5902	7.76	6314	7.91
Finanace and Real Estate	7532	9.90	7909	9.90
Community and Social Services	7764	10.20	8087	10.13
Agriculture GDP	31535	41.44	32566	40.78
Non-agriculture GDP	44560	58.56	47289	59.22
Total GDP	76095	100.00	79855	100.00

Source : Economic Survey, 1996/97, HMG/N.

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It is seen from the Table 1 that still agriculture sector has pivotal role in the Nepalese economy since it has contributed 40.78 percent in GDP where as other eight economic sectors have contributed 59.22 percent in GDP in FY 1996/97. The contribution of manufacturing sector in GDP is still less than 10 percent which indicates that Nepal's industrialisation is at very primitive stage.

Per capita GDP at current prices in FY 1995/96 grew by 11.2 percent where as it is expected to increase by 10 to 11 percent in FY 1996/97 compared to FY 1995/96. Similarly, gross national investment in 1995/96 increased by 18.1 percent where as it is expected to decline slightly during FY 1996/97. Nepal's gross domestic savings rate has been lower than that of other developing and neighbouring Asian countries. The gross domestic saving was about 11 percent in FY 1995/96. This rate is expected to further decline in FY 1996/97.

During the first nine months of FY 1996/97, total foreign trade rose by 23 percent over the corresponding period of the previous fiscal year. This indicates an improvement in the international trade situation of the country. The exports increased by 16.3 percent where as imports increased by 25.6 percent during that period. And, hence, trade deficit during the first nine months of FY 1996/97 as compared to the deficit of the corressponding period of the previous years increased by 29 percent. During the first nine months of FY 1996/97, the national consumer price index has increased at a higher rate compared to the corresponding period of the previous fiscal year (MOF 1997).

INDUSTRIAL ENTERPRISES ACT 1992, INDUSTRIAL POLICY 1992, FOREIGN INVESTMENT AND ONE WINDOW POLICY 1992 AND FOREIGN INVESTMENT AND TECHNOLOGY TRANSFER ACT 1992: AN ATTRACTION FOR FOREIGN INVESTMENT IN NEPAL

After the installation of multiparty democratic system in the country, the elected government adopted the new policy measures in several economic spheres including new industrial and foreign investment and one window policy for speeding up the process of industrialisation through mobilising the local capital as well as attracting foreign investment and technology in the country. According to the spirit of these policies, the Industrial Enterprises Act (IEA) 1992 and Foreign Investment and Technology Transfer Act (FITTA) 1992 was enacted. Accordingly, foreign investment is welcome in Nepal in all types of industries except the defense related industries, cottage, small scale and the medium scale industries having less than NRs. 20 million in the fixed asset as well as cigarette, bidi, alcohol, exculding 100 percent export oriented industries. Foreign investors are permitted to have a joint venture unit with Nepalese partner or 100 percent foreign owned unit. However, permission may be granted for the transfer of technology in cottage, small scale and medium scale industries with less than NRs. 20 million investment in the fixed asset .

The industrial Policy (IP) 1992 has made the provision to the foreign investors who have received permission to invest in convertible foreign courrency to repatriate the followig amount outside Nepal at the prevailing rate of exchange :

- The amount received by sale of the whole or any part of the equity investment.
- The amount received as benefits or dividends from foreign investment.
- The amount received as payment of principal and interest on foreign loans.
- The amount received under an agreement for the transfer of technology.
- The amount received as compensation for the acquisition of any property.
- Foreign experts, working in Nepalese industries with prior approval from countries where convertible currencies are in circulation shall be permitted to repatriate in convertible foreign currency upto 75 percent of the amount received by them as salaries, allowances etc.

This IP (1992) has made a provision to provide the facilities and concessions to the foreign investors as follows:

- Interest income on foreign loans will be taxed at a rate of 15 percent only.
- Royalties, technical and management fees will be taxed at a rate of 15 percent.
- No income tax will be levied on the income earned from exports.

- Industries established with foreign investment are entitled to enjoy all the facilities and incentives including income tax facilities provided to local investment under the Industrial Enterprise Act 1992.

The IEA 1992 has provisioned to grant the facilities and concession to the industries as follows:

- Manufacturing industries, except cigarettes, bidi, alcohol, beer, vegetable ghee, plastic, and electronic assembly, energy-based, agro and forest-based, except saw mill and match, and mining industries shall be entitled to an income tax exemption for a period of five years from the date of commercial production by the industry.
- The industries classified under national priority shall be entitled to an income tax exemption for an additional period of two years.
- Industries shall be entitled to a reduction in tax rate on each income slab or corporate tax by 5 points.
- Industries, other than cirgarette, bidi, alcohol, and beer established in the remote, undeveloped, underdeveloped and relatively developed areas will be granted a rebate or 60,50,20, and 10 percent of the income tax and 35, 25,15 and 10 percent of excise duty respectively.
- Fruit based processing and cider and wine industries with a fixed asset of upto two million and five hundred thousand Nepalese rupees established in remote areas shall be entitled to excise duty and sales tax exemption for a period of ten years respectively, and fruit based alcohol industries shall be entitled to excise duty and sales tax exemption for a period of five years.
- While calculating depreciation on the fixed assets, industries shall be entitled to add one third to the rate of depreciation allowed under the existing income tax laws.
- If an indsutry diversifies itself through reinvestment in the same or any other indsury, or expands its installed capacity by 25 percent or more, modernises its technology or develops ancillary indsutries, it shall be entitled to a deduction of 40 percent of new additional fixed assets from its taxable income.

- Permission hall be granted for a reduction of upto 50 percent from the taxable income for the investment of an industry on process or equipment, which has the objective of controlling pollution or which may have a minimum effect on the environment.
- Pre-operation costs incurred by any indsutry in connection with skill development training shall be allowed to be capitalised .
- Prescribed tourism, service, and construction industries shall be entitled to income tax exemption upto a period of five years.
- After an industry comes into operation, 10 percent of the gross profit shall be allowed as a deducation against taxable income on account of expenses related with technology, product development and efficiency improvement.
- No income tax shall be imposed on dividends earned out of the investment made in any industry.
- Upto 5 percent of gross income spent for the advertisement of the products or promotion services, hospitality and any other similar expenses shall be allowed to be deducted while assessing the taxable income.
- If a single industry provides direct employment to six hundred or more people, it shall be granted income tax exemption for an additional period of two years.
- If any other industry utilises locally available raw materials, chemicals and packing materials etc. on which excise duty or sales tax or both are already imposed, the excise duty, sales tax or both shall be reimbursed to the industry utilising such raw material, chemicals and packing materials.
- No income tax shall be levied on the profits earned through export.
- The custom duty, sales tax, excise duty and premium levied on raw materials, and auxiliary raw materials etc., utilised by any industry in connection with its productions shall be reimbursed on the basis of the quantity of the export.
- An industry exporting 90 percent or more of its products shall be entitled to enjoy the same facilities as are accorded to the industries established in the Export Processing Zone.

- If an indsutry sells its product within the Kingdom in any foreign currency, the excise duty, sales tax and premium levied on such product and customs duty, excise duty and slaes tax levied on the raw materials, auxiliary raw materials etc., utilised in such product shall be reimbursed.
- The customs duty, sales tax, excise duty and premium levied on the production materials of intermediate goods to be utilised for the production of exportable goods, and the sales tax and excise duty levied on he production shall be reimbursed to the industry manufacturing goods on the basis of the quantity of export.
- No tax, duty or fee shall be levied on the machinery, tools and raw materials, utilised by any industry established in the Export Processing Zone and on the exportable products.
- Double sales tax shall not be levied on the raw materials and products of any indsutry.
- An income tax exemption for an additional period of two years shall be granted to any indsutry established wiht a fixed capital investment of more than seven hundred and fifty million Nepalese rupeess.

The FITTA 1992 has made a provision for the settlement of disputes as follows:

- If any dispute arises between a foreign investor, national investor or the concerned industry, the concerned parties shall be required to settle the dispute by mutual consultation in the presence of the Department of Industry.
- If the dispute could not be settled in the manner as referred above, it shall be settled by arbitration in accordance with the prevailing Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL).
- The arbitration shall be held in Kathmandu, the laws of Nepal shall be applicable in the arbitration.

Porvisions made in the FITTA 1992 regarding the visa facilities for foreign investors are as follows:

- A foreign national visiting the kingdom of Nepal in connection with undertaking any study or carrying out any reserach with the objective of making investment in the Kingdom of Nepal shall be provided a non-tourist visa for upto six months.
- A foreign investor and or his dependents or his authorised representative shall be, for the purpose of stay in Kingdom of Nepal, provided a non-tourist visa. Provided that a foreign investor, who at a time, makes convertible foreign currency investment in an amount more that one million United States dollars and his dependents, shall be granted a residential visa until such investment is retained.

TREND OF FOREIGN INVESTMENT AFTER FITTA 1992 AND IEA 1992

After the introduction of new policy and new IEA and FITTA in 1992, His Majesty's Government of Nepal with the co-operation of UNDO/UNIDO organised a *Neapl Investment Forum* in Kathmandu from November 30 to December 4, 1992 to accelerate the pace of industrialisation by attracting FDI and technology in the country. During that forum, 306 business men, indsutrialists and financiers from 26 differnt countries of Asia, Europe and North America participated and held business discussion with Nepalese investors. At this forum, 128 letters of intent were signed involving an envisaged investment of US $ 740 million.

Due to the concerted efforts of government and private investors after the implementation of new policy and act, the number of foreign investment projects significantly increased. The trend of foreign investment projects after FITTA 1992 has been depicted in Table 2.

Table 2

Trends In Foreign Investment Project

(In Million NRs.)

Fiscal Year	Number Of Project	Total Project Cost	Total Foreign Investment	Total Number Of Employment
1976 to 1991/92	147	12211.74	1850.03	28605
1992/93	62	17873.08	3747.48	13867
1993/94	38	3322.76	909.47	4734
1994/95	18	1571.52	477.59	2356
1995/96	45	9715.03	2204.95	7947
1996/97	64	7150.04	2223.90	8924
Total	374	51844.18	22826.84	132866

Source: Foreign Investment Section, Department of Industry, HMG/N.

It is seen from the Table 2 that 147 projects were approved since the beginning i.e., 1976 to FY 1991/92. Only in the FY 1992/93, 62 industrial projects with foreign investment were approved. Similarly, 38 projects obtained the approval for bringing foreign investment and technology in the country. In the fiscal year 1996/97, 64 industrial projects were approved. These figures clearly indicate that above mentioned policy reform has created the some sort of favourable atmosphere for foreign investment and technolgoy transfer.

Present Status Of Apporved Foreign Investment Projects

From the beginning upto FY 1996/97, 374 indsutrial projects obtained the premission for foreign investment. Out of them, 163 industrial projects are in operation, 37 industrial projects are in under construction. Out of remaining 174 approved industrial porjects, 112 applicants taken the permission letter from the Department of Industries (DOI) 45 applicants have not taken the permission letter from the DOI, 9 indsutrial projects are already closed and 8 approvals for foreign investment are canceled. The summary of status of approved projects are exhibited in Table 3.

Table No. 3
Status of Foreign Investment Project In Nepal

(In Million NRs.)

Status Of Industries	Number	Project Cost	Foreign Investment
Operation	163	177740.70	2920.19
Under-construction	37	15781.19	3050.02
Licensed	112	12178.39	3750.27
Approved	45	5301.72	1690.23
Closed	9	495.46	120.64
Canceled	8	346.67	62.06

Source: Foreign Investment Section, Department of Industry, HMG./N.

Sector-wise Trend Of Foreign Investment Porjects

Out of 374 industrial projects with foreign investment, 211 projects are of manufacturing type, 77 industrial projects are under hotel and resort type. service industries category stands in third position with 36 industrial projects, 12 number of agriculture and foresty based industry obtained the approval for foreign investment. Similarly, transport and communciation type have 14 numbers. Electricity, water and gas category have only 6 projects. Construction and housing industry have 8 and 9 projects respectively.

Out of 211 manufacturing industries, textile and ready-made garment industries stands in the first position in temrs of number of projects which accounts 56 projects. Chemical and plastic industries and food and beverage industries follow the textile group with 44 and 43 projects respectively. Fabricated metal product stands in the fourth position with 36 projects. Other type of manufacturing industries such as wood and wood product industries, paper and paper product, non-metallic product, basic metal industries with foreign investment are in few numbers. The summary of above discussion has been exhibited in Table 4.

Table No. 4

Types Of Foreign Investment In Different Sectors

Type of Industries	Number of Project
Agriculture and Forestry	12
Manufacturing	211
Food, Beverage and Tobacco	43
Textile and Ready-made Garment	56
Wood and Wood Product	4
Paper and Paper Product	2
Chemical and Plastic Product	44
Non-Metallic Product	9
Basic Metal Product	12
Fabricated Metal Product, Machinery and Equipment	36
Other Manufacturing Units	5
Electricity, Water and Gas	6
Construction	8
Hotel and Resort	77
Transport and Communication	14
Housing and Aparment	9
Service Industries	37

Source: Foreign Investment Section, Department of Industry, HMG/N.

Table No. 5

Countrywise Trend Of Foreign Investment Project

Name Of The Country	No. Number Of Projects
India	135
Japan	40
USA	31
China	22
South Korea	18
Germany	16
France	11
Hongkong	11
Others	90
Total	374

Source: Foreign Investment Section, Department of Industry, HMG/N.

Indian investors participated in about half number of projects so far approved. Japanese investors stand in the second position with 40 industrial projects, after that USA and China follow with 31 and 22 number of industrial projects respectively. Other important countries from where investors particiapted to accelerate the pace of industrialisation are South Korea, Germany, France and Hongkong. The summary of foreign investment by country-wise is exhibited in Table 5.

PRESENT INVESTMENT CLIMATE FOR FOREIGN INVESTORS IN NEPAL

His Majesty's Government of Nepal has made some changes in FITTA (1992) in 1996 for making the investment climate more conducive to accelerate the pace of industrialisation by attracting the foreign investment and technology in the country. Some of the important changes are as follows:

- The minimum requirement limit in the fixed asset investment has been relaxed to participate in equity or loan investment. Previously, foreign investors were permitted to particiapate in the industrial project having more than 20 million Nepalese rupees investment in the fixed asset.
- The tax on interest earnings, which was previously 15 percent has been removed.
- The negative list of foreign investment project, which was previously limited to 3 items, has been increased to 23 numbers by dividing into 2 parts, the list of first part may be changed only by making amendment in the FITTA and the list of second part may be changed by publishing the notice in the gazette.
- A foreign investor and/or his/her dependents or his/her authorised representative shall be granted a business visa. Previously they are granted a non-tourist visa.
- A foreign investor who at a time makes an investment in an amount more than 100 thousand US dollar (previously 1 million US dollar) and his her dependents shall be granted a residential visa until such investment is retained.

- The arbitration provision made in FITTA has been relaxed to the industrial projects having more than 500 million Nepalese rupees investment in the fixed asset.
- IEA (1992) too has been amended by Ordinance 1997. This ordinance has made two major changes in the previous provisions. Firstly, The provision of income tax holidays has been removed. Secondly, the corporate tax has been reduced from 33 percent to 20 percent.

INTERNATIONAL COMPARISION OF INVESTMENT CLIMATE

The tax system of Nepal has been compared with that of India, Pakistan, and Bangladesh and is exhibited in Table 6. It is seen from the Table 6 that the tax structure is highly competitive with that of other South Asian countries. Since, the corporate tax, which is only 20 percent in Nepal, is very low in comparision to these three countries. However, the recent change made in abolishing the tax exemption provision has made the country less competitive to that of these South Asian countries.

Table No. 6

Comparative Table Of The Tax System Of Nepal With Other SAARC Countries

Type of Incetive	Nepal	Pakistan	India	Bangladesh
Corporate Tax Rate	20 Percent	43 Percent	55 Percent	47.5 Percent
Basic Tax Holidays	None	3 Years.	None	5 Years.
Special Tax Holidays	None	Up to 8 Years.	Up to 5 Years.	Up to 7 Years.
Accelerated Depreciation	Yes	Yes	No	Yes
Special Deduction, Credit etc.	Yes	Yes	Yes-complex	No
Tax Exempt in Capital Gains	Yes	No	No	No
Tax Exempt in Foreign Interest	Yes	No	Yes	Yes
Tax Exempt in Exports	Yes	Yes	Limited	Yes
Export Duty Drawback	Yes	Yes	Unknown	Yes
Consumption Tax Concessions	Yes	Yes-complex	Yes-complex	No.

Source : Industrial Development News for Asia And The Pacific, UN/ESCAP, No. 18, 19, Bangkok.

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