FOREIGN DIRECT INVESTMENT THROUGH PRIVATIZATION IN DEVELOPING COUNTRIES

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INTRODUCTION

The role of foreign capital in the process of industrialisation and technology transfer cannot be undermined. Recent experience of many of the developing economics has been such that foreign direct investment (FDI), under appropriate conditions, makes a substantial contribution to their development. (Pyakuryal; 1995) Due to the worldwide economic and financial crisis, many donor countries have curtailed their official development assistance to developing countries. Therefore, private foreign capital remains the only alternative source available to developing countries. (Regmi; 1994)

Transnational corporations (TNCs) or Multinational corporations (MNCs) with their vast capital assets, sophisticated technology and worldwide marketing arrangements have emerged as a powerful source of private foreign investment. They have proved to be relatively efficient agents in transferring technology to developing countries. (Regmi; 1994) As a result, many developing countries are now aggressively moving forward to increase the inflow of foreign direct investment by instituting active investment promotion programme. (Pyakuryal; 1995)

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Burdensome public sector debts, continued poor performance of many state-owned enterprises (SOEs), the adoption of market-friendly policies in the 1980s and the desire to attract FDI have led to the implementation of privatization programmes allowing TNC participation in many parts of the world. The number of privatized enterprises worldwide has grown rapidly in recent years, with the value of privatization sales amounting to at least $ 185 billion over the period 1988 to 1992 (not included are privatization in the former German Democratic Republic). (UNCTAD; 1994) Only few privatization in developed countries involved complete sales to foreign investors; in certain cases, a portion of the shares of the privatized companies (typically in the range of 15 to 20 percent) was offered for sale in equity markets abroad. The British government retained the "Golden Share" to prevent absolute foreign control when British Aerospace was put on the market. (Sharma; 1995)

As a result of the greater restrictions imposed by developed countries on foreign participation in privatization programme, the importance of privatization- induced FDI in these countries has been smaller than in developing countries. Of all regions of the world, Central and Eastern Europe has experienced the largest share of FDI from privatization amounted to over $ 5.2 billion or 67 percent of total FDI inflows to that region (Table: 1).

Table 1: Foreign direct investment from privatization in developing countries (millions of dollars and percentage)

Region	1988	1989	1990	1991	1992	Cumu-lative 1988-1992
North Africa and Western Asia						
FDI from privatization	-	1	-	3	22	27
Share of total FDI inflows	-	0.05	-	0.21	1.01	0.29
Sub-Saharan Africa						
FDI from privatization	-	14	38	3	44	99
Share of total FDI inflows	-	0.4	3.7	0.2	2.7	1.1
East Asia and the Pacific						
FDI from privatization	-	-	-	75	302	377
Share of total FDI inflows	-	-	-	0.37	1.03	0.38
South Asia						
FDI from Privatization	-	0.1	11	4	37	52
Share of total FDI inflows		0.02	2.0	0.9	5.8	2.1
Latin America and the Caribbean						
FDI from Privatization	214	157	2136	3300	2312	8119
Share of total FDI inflows	2.4	2.5	24.7	22.0	13.1	14.3
All Developing Regions						
FDI from Privatization	214	172	2185	3385	2717	8673
Share of total FDI inflows	0.8	0.6	6.0	8.7	5.3	4.9
Memorandum						
Central and Eastern Europe						
FDI from Privatization	-	422	489	1917	2411	5238
Share of total FDI inflows	-			74.7	52.5	66.8

Source: UNCTAD, World investment report, 1994, p. 27.

The privatization of over 4000 medium-sized and large state-owned enterprises in developing countries over the period 1988-1992 has generated over $ 49 billion in total sales. Of these, sales to foreign direct investors were $ 8.7 billion or about 17 percent. (UNCTAD; 1994) Foreign direct investment through privatization accounted for about 5 percent of total FDI flows to developing countries over that period, with marked regional variations (Table: 1).

Above table revealed that of all developing regions, Latin America and the Caribbean experienced the largest inflow of FDI from privatization (14 percent of total FDI inflow overall, with much higher shares- nearly 25 percent in 1990 and 1991). Other regions has considerably less privatization activity and also considerably lower shares of privatization associated FDI flows. Among developing countries, Asian region accounts for only 122 (6 percent) sales or liquidations of state-owned firms over the period 1980 to 1991. (Kikeri; 1992) Due to the limited privatization activity in this region (including East Asia and the Pacific and South Asia), the inflow of FDI from privatization accounted for only 2.48 percent of total FDI inflows. Generally, for countries that have implemented privatization programmes, the flow of FDI induced through them is determined largely by the overall value and attractiveness of the assets being privatized, restrictions on foreign participation in privatization programmes, the overall investment climate of the country and the presence of fairly developed capital market.

Multilateral Investment Guarantee Agency (MIGA), established in 1988, encourages foreign private direct investment in developing countries by providing long-term investment insurance (guarantees) against non-commercial risks, in particular, the risks of currency transfer, expropriation, breach of contract, and war and civil disturbance. However, MIGA's involvement in privatization has so far been limited.(Kikeri; 1992)

FOREIGN DIRECT INVESTMENT THROUGH PRIVATIZATION IN NEPAL

The history of foreign private investment in Nepal can be traced back to 1936 when the first jute mill was established in Biratnagar in joint collaboration with Indian merchants. (Regmi; 1994) But there was no clear policy of the government to attract foreign capital. (Acharya; 2048) In Nepal, emphasis on foreign investment was given since the Sixth Plan (1980-85). (Chitrakar; 1986) Separate rules and regulations and lucrative incentives have been provided for the foreign investors since 1981 to enhance foreign investment In Nepal.

The Foreign Investment and Technology Transfer Act, 1992 and the Industrial Enterprises Act, 1992 are such important legislative acts that address foreign private investment regime in Nepal. Various modification for safeguarding the interest of private sector are brought about in the Acts of 1992 as compared to the Industrial Enterprises Act of 1982 and the Foreign Investment and Technology Act of 1981. (Pyakuryal; 1995)

At present, there are altogether 278 projects under joint collaboration approved so far. Out of these, 241 projects have been approved for financial participation and 74 for technology transfer. The total project cost of these 278 projects is Rs. 33616 million and foreign portion is Rs. 7435 (nearly 22 percent, million (Table: 2).

Table 2: Foreign direct investment approval

Fiscal Year	No. of Units	Total Project Cost (Rs. in Million)	Foreign Investment (Rs. in Million)	Employment
Upto 1990-91	110	6736	1192	22990
1991-92	39	3325	593	5726
1992-93	61	17531	3701	13795
1993-94	38	3323	909	4734
1994-95	17	1032	478	1916
1995-96*	13	1670	563	1747
Total	278	33616	7435	50908

Source: Department of industries, MOI, HMG.
* Only first four months, i.e. Shrawan to Kartik.

Of the total approved foreign investment, 148 units are in operation, 34 are in various stages of construction, 69 are in licensed, 21 are approved only. and 6 others. The Manufacturing sector accounts for 61.15 percent of total foreign investment followed by tourism (19.04 percent), services (14.39 percent), agriculture (2.52 percent) and energy based (1.80 percent).

It is clearly evident from the table 2 that the total number of projects as well as total investment under joint ventures have been increased every year. However, the number of projects and foreign investment flows have been decreased in the subsequent years especially since the Fiscal Year 1993-94. Since the HMG has adopted the liberal economic in recent years, various policies reforms have been initiated and incentives are also given to foreign investors. In spite of these efforts, FDI activities in Nepal is not so encouraging. Absence of political instability, unavailability of productive and skilled labour, inability to overcome infrastructure bottlenecks particularly the shortage of power etc., are some of the economic and environmental factors responsible for discouraging FDI in Nepal.

Although privatization policy in Nepal has initiated during the Sixth Five Year Plan (1980-85), the real effort to sell the ownership of public enterprises could take place only after the establishment of the democracy in the country. (Manandhar; 1995) During 1992-94, the Nepali Congress Government privatized eight public enterprises with the total sales proceeds of around Rs. 567 million. Among the privatized enterprises, only one unit, i.e. Bansbari Leather and Shoe Factory was sold to an Indian national for Rs. 22.40 ($ 0.45) million. The other enterprise with foreign investment is Brikuti Paper Mills Ltd. with 20 percent share of Inter Match Ltd. U.K. (Rastrasewak; 1995)

The UML Government did privatized a cigarette factory (Seti Cigarette Factory) during their nine months long tenure. (Manandhar; 1995) The present coalition government has reiterated once again, privatization as a chief ingredient of broader economic liberalisation policy. So far three units have been listed for privatization. They include a sick jute industry, a foundry and the selling of government owned shares in the Seti Cigarette Factory.

The above pictures show that the foreign direct investment through privatization remained insignificant (about 3.95 percent of total sales proceeds and 0.16 percent of the foreign direct investment approved for the FY 1992-93) in Nepal. The government clearly indicated from the very start of the privatization program, that Nepalese investors will be given priority over foreigners if the proposals were similar. (Sharma; 1995) As stated in the "Privatization Act, 1993", if the proposals of two or more investors are found to be identical, priority shall be given to the Nepali investor or group of Nepali investors. (Privatization Act 1993; Sec. 10(2)) It means that the foreign participation in certain cases has so far been allowed partially.

Nepal is such a country where due to the frequent dissolution of the parliament, two annual budget speeches were presented four times within a short span of 15 months period. With the restoration of the dissolved parliament, a new coalition government came to power. It clearly indicates that the high degree of political instability is being continued, which prevents the creation of a congenial investment climate and the adoption of consistent privatization policy in the country.

CONCLUSION

The foreign capital can play an important role in the process of industrialization. Transnational corporations with their vast capital assets, advanced technology and worldwide marketing arrangements have emerged as a powerful source of private foreign investment. Continued poor performance of state-owned enterprises and the desire to attract FDI have led to the implementation of privatization programmes allowing TNC participation. Foreign direct investment through privatization accounted for about 5 percent of total FDI flows to developing countries over the period 1988-92. However, due to the political instability, limited privatization activity and the partial restriction on foreign participation, the foreign direct investment through privatization remained insignificant in Nepal.

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