



# IPR

INVESTMENT **POLICY** REVIEW



**REPORT ON THE IMPLEMENTATION  
OF THE INVESTMENT POLICY REVIEW**

**NEPAL**



UNITED NATIONS



UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

**UNCTAD**



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**NEPAL**



UNITED NATIONS  
Geneva, 2019

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- **A blank in a table** indicates that the item is not applicable.
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- **Details and percentages** in tables do not necessarily add to totals because of rounding.



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# ABBREVIATIONS

<b>BIMSTEC</b>	Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
<b>BIT</b>	bilateral investment treaty
<b>BPO</b>	business process outsourcing
<b>CIT</b>	corporate income tax
<b>DOI</b>	Department of Industry
<b>DTAA</b>	double taxation avoidance agreement
<b>FDI</b>	foreign direct investment
<b>FITTA</b>	Foreign Investment and Technology Transfer Act
<b>GDP</b>	gross domestic product
<b>GON</b>	Government of Nepal
<b>HPP</b>	hydropower plant
<b>IBN</b>	Investment Board of Nepal
<b>ICT</b>	information and communications technology
<b>ID</b>	industrial district
<b>IFRS</b>	International Financial Reporting Standards
<b>IPA</b>	investment promotion agency
<b>IPFSD</b>	Investment Policy Framework for Sustainable Development
<b>IPR</b>	investment policy review



<b>IT</b>	information technology
<b>LDC</b>	least developed country
<b>MAP</b>	medicinal and aromatic plants
<b>MoICS</b>	Ministry of Industry, Commerce and Supplies
<b>MOU</b>	memorandum of understanding
<b>NPR</b>	Nepali rupees
<b>NEA</b>	Nepal Electricity Authority
<b>NRB</b>	Nepal Rastra Bank
<b>OSS</b>	one-stop shop
<b>PPA</b>	power purchase agreements
<b>PPP</b>	public-private partnership
<b>SAFTA</b>	South Asian Free Trade Agreement
<b>SEZ</b>	special economic zone
<b>SME</b>	small and medium-sized enterprise
<b>SOE</b>	State-owned enterprise
<b>TRIPS</b>	Trade-Related Aspects of Intellectual Property Rights
<b>UNDP</b>	United Nations Development Programme
<b>VAT</b>	value added tax



# INVESTMENT POLICY REVIEW SERIES

1. Egypt (1999)
2. Uzbekistan (1999)
3. Uganda (2000)
4. Peru (2000)
5. Mauritius (2001)
6. Ecuador (2001)
7. Ethiopia (2002)
8. United Republic of Tanzania (2002)
9. Botswana (2003)
10. Ghana (2003)
11. Lesotho (2003)
12. Nepal (2003)
13. Sri Lanka (2004)
14. Algeria (2004)
15. Benin (2005)
16. Kenya (2005)
17. Colombia (2006)
18. Rwanda (2006)
19. Zambia (2007)
20. Morocco (2008)
21. Viet Nam (2008)
22. Dominican Republic (2009)
23. Nigeria (2009)
24. Mauritania (2009)
25. Burkina Faso (2009)
26. Belarus (2009)
27. Burundi (2010)
28. Sierra Leone (2010)
29. El Salvador (2010)
30. Guatemala (2011)
31. The former Yugoslav Republic of Macedonia (2011)
32. Mozambique (2012)
33. Djibouti (2013)
34. Mongolia (2013)
35. Bangladesh (2013)
36. Republic of Moldova (2013)
37. Republic of the Congo (2015)
38. Sudan (2015)
39. Bosnia and Herzegovina (2015)
40. Kyrgyzstan (2015)
41. Madagascar (2015)
42. Tajikistan (2016)
43. The Gambia (2017)
44. South-East Europe (2017)
45. Lebanon (2018)
46. Cabo Verde (2018)
47. Chad (2019)
48. Angola (2019)
49. Armenia (2019)
50. Côte d'Ivoire (2019)





# 1. INTRODUCTION

In 2003, UNCTAD published the Investment Policy Review (IPR) of Nepal, which highlighted a 20-year vision for attracting and benefitting from foreign direct investment (FDI) in the country. This Implementation Report presents an assessment of the progress made towards that vision and the recommendations contained in the original report, taking into account developments in the political and economic context since that time.

Years of civil unrest came to an end in 2006, when a comprehensive peace agreement was signed. A new Constitution, enacted in 2015, created a federal system of government that devolved functions to the seven provinces, including some relevant to business operations and investment.

The Government wants Nepal to achieve graduation from least developed country (LDC) status by 2021 and to become a middle-income country by 2030. Towards this end, it has undertaken reforms to boost foreign and domestic investment. They include updating the investment legislation, simplifying administrative procedures, strengthening investment promotion institutions, facilitating access to finance and foreign exchange, simplifying the tax regime, and establishing special economic zones. It has also organized events to showcase the country's potential, including through the third Nepal Investment Summit held in March 2019. Nepal's investment promotion assets include abundant natural resources, a young labour force, a largely unexploited services sector and access to large markets in China and India.

As a result of the reform undertaken, Nepal has progressed 16 positions in the ease of doing business rankings compared to the previous year. It is now ranked 94<sup>th</sup> (World Bank, 2019). The country was also identified as a top improver in Euromoney's Crowd-Sourcing Risk Survey.<sup>1</sup>

While the business environment has improved, some key deterrents to investment identified by the IPR in 2003 remain. The investment environment has also become somewhat more restrictive. For example, some activities have since been closed to foreign investment and the minimum threshold for the entry of foreign investors has increased, which effectively closes the door to small and medium-sized FDI projects. Deeper reforms are required to clarify FDI entry provisions, further ease bureaucratic procedures, simplify the taxation system, and address competition and governance issues and change the perception towards the country. Also, the Government should ensure that reforms are implemented in a coherent manner through improved public-private dialogue and strengthened institutional and technical capacities.



The IPR had also recommended that Nepal explore three avenues for FDI attraction, including in tourism, export manufacturing and herbal products. While the potential in export manufacturing may have somewhat eroded, the tourism and herbal sectors still offer good scope for foreign investment. Furthermore, increased demand for the country's huge hydropower resources, its growing IT sector and mining activities may also provide new investment opportunities for FDI. Improving the efficiency of investment promotion efforts will be key to better exploit them.<sup>2</sup>



## 2. KEY ECONOMIC AND FOREIGN DIRECT INVESTMENT TRENDS

Since the publication of the IPR, annual gross domestic product (GDP) has been growing at an annual average of 4.4 per cent, and by 7 per cent in the last three years, due in part to the reconstruction efforts after the devastating earthquake of 2015. Several other economic indicators have also improved, which overall contributed to reducing poverty.<sup>3</sup> The structure of the economy has changed during the same period, with a slight shift towards services, which now account for 50 per cent of value added (up from 44 per cent in 2003). Agriculture, which employs some 65 per cent of the workforce, declined from 35 per cent of value added to 25 per cent, falling 5 percentage points since 2014 alone. Industry, including manufacturing, has decreased from 17 to 13 per cent of value added, even as FDI to the sector has increased.

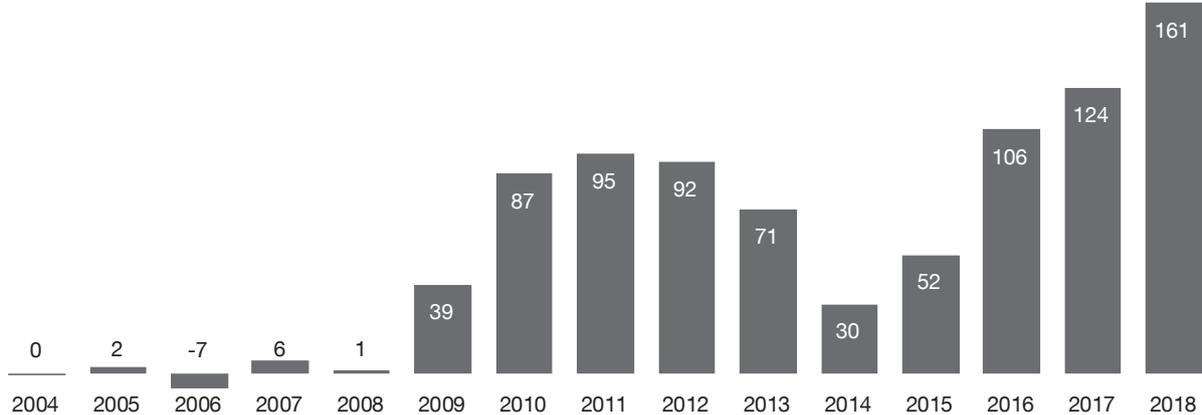
Nepal's growth has partly been underwritten by remittances (equivalent to 28 per cent of GDP in 2017, the 5<sup>th</sup> largest share globally) and official development assistance.<sup>4</sup> Remittances have also helped make up for growing trade deficits. Significantly, trade liberalisation in Nepal resulted in a rapid increase in imports after 2002. The merchandise trade deficit widened to \$12.6 billion in 2018 (estimated), up from \$9.6 billion in 2017, with imports increasing 14 per cent in 2017 to \$10 billion.<sup>5</sup> In 2017, service imports also overtook exports. The resulting trade imbalances are fuelling balance of payments difficulties. In this context, FDI could play a role to increase efficiencies and boost exports. However, in the years following the IPR, FDI inflows to Nepal were negligible and even today, they represent less than one per cent of total capital inflows.

When looking at Nepal's recent FDI attraction performance (figure 1), four major periods can be distinguished. Between 2004 and 2008, FDI inflows were held back by political instability. Except for one large investment in the hydropower sector, greenfield investments were small scale and mergers and acquisitions negligible. Between 2009 and 2011, peace dividends materialized, and the Government set the legal and institutional framework to mobilize large investments in public infrastructure, including through public-private partnerships (PPPs) (see section III.4). Some greenfield investments in hydropower and transport raised the country's profile (e.g. GMR Group, Sinohydro, Indian Railways) and FDI inflows started to pick up. From 2012 to 2014, FDI inflows fell partly as a result of a slowing Indian economy — Nepal's main FDI source country — which led to significant divestment by Indian firms (UNCTAD, 2014).<sup>6</sup>



After 2015, the reconstruction efforts related to the earthquake led to increased spending on public infrastructure, which created demand in the construction sector. FDI flows recovered and have since been increasing steadily. Some mega-projects in hydropower (Arun-3) and investments in cement industries (Hongshi, Huaxin) began operations. In the telecommunications sector, Axiata (Malaysia) acquired Ncell, the affiliate of Teliasonera (Sweden), in 2016. Finally, there has also been some diversification of FDI in the service industries, including banking and pharmaceuticals. The commitment of the Government to positive investment-related measures can be correlated with increasing flows.

**Figure 1. FDI inflows to Nepal, 2004–2018**  
(millions of dollars)



Source: UNCTAD FDI/MNE database.

The picture looks less optimistic, however, when considering Nepal’s relative FDI performance, which has remained stagnant both in terms of FDI relative to GDP and as a percentage of gross fixed capital formation (table 1). FDI stock currently represents 7 per cent of GDP, and average inflows of FDI have been significantly lower than in other LDCs, including in Asia. Nepal significantly lags other regional LDCs and landlocked economies in both relative and absolute terms.



Table 1. Comparative FDI performance, Nepal and selected countries, 2004–2018

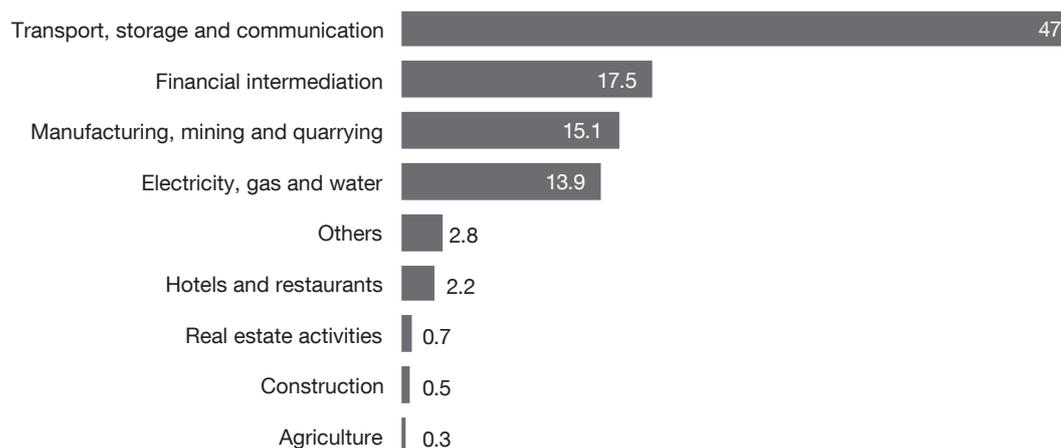
Country	Average inflows of foreign direct investment												Foreign direct investment stock		
	Millions of dollars			Per capita (dollars)			Per \$1 000 gross domestic product			As percentage of gross fixed capital formation			Total (millions of dollars)	Per capita (dollars)	Percentage of gross domestic product
	2004–2008	2009–2013	2014–2018	2004–2008	2009–2013	2014–2018	2004–2008	2009–2013	2014–2018	2004–2008	2009–2013	2014–2018	2018		
Nepal	0	77	96	0	3	3	0	5	4	0	2	1	1938	65	7
Bangladesh	770	1128	2377	5	7	15	11	9	11	4	3	3	17062	103	6
Bhutan	26	30	3	39	40	4	28	17	2	6	3	0	138	168	5
Cambodia	548	1600	2409	40	109	152	67	123	118	36	71	54	23741	1461	97
Kyrgyzstan	197	448	389	38	81	66	58	75	57	28	27	21	3917	639	49
Lao PDR	157	298	1151	26	47	170	36	34	73	12	11	24	8665	1245	48
Mongolia	349	2644	-11	135	950	-9	74	261	-6	21	61	-29	20223	6478	160
Sri Lanka	466	742	1091	24	36	52	13	12	13	6	4	4	12757	609	14
LDCs	11140	21424	27023	14	25	28	26	29	27	12	12	11	353771	349	33
LDCs: Asia	2809	4818	8792	10	16	26	19	19	22	9	8	7	86785	256	18

Source: UNCTAD (2019), FDI/MNE database.

According to data from the Nepal Rastra Bank (NRB), the central bank, the bulk of the FDI stock in Nepal is held by firms from India, followed by China, Singapore, Ireland and the Republic of Korea, based on equity alone. However, when reserves and loans are included, economies from the Caribbean region account for by far the largest share of FDI stock.<sup>7</sup> This is due to the rise in investments from off-shore centres in the Caribbean, likely a signal of round-tripping investments from Nepali investors, which indeed overestimates the real impact of foreign-owned firms (NRB, 2018).



**Figure 2. Distribution of FDI stock (equity) by sector, 2016**  
(percentage)



Source: Nepal Rastra Bank.

The largest share of FDI stock in 2016 was in transport, storage and communication, of which communication accounted for the vast majority, possibly linked to investments in Ncell by Axiata (Malaysia) (figure 2). In total, services account for more than 70 per cent of FDI stock, followed by industrial activities in manufacturing and mining, and in the electricity, gas and water sectors, reflecting projects in hydropower and cement production. The share of agriculture is minimal, as legislation on primary production has been highly restrictive for foreign investors. In the tourism sector, figures may underestimate foreign presence as several hotel chains have non-equity arrangements with local partners under licencing agreements (for example the Marriot and Sheraton hotel chains).<sup>8</sup>



# 3. SUMMARY OF MAIN FINDINGS

In 2003, the IPR highlighted significant potential for FDI attraction. In addition to having preferential access to a neighbouring country with a large market size, Nepal benefitted from a flourishing entrepreneurial culture and an established international image. Standing in the way of this potential was Nepal's investment framework, which, at the time of the IPR, was considered overly restrictive to foreign involvement. This was further compounded by inefficient administrative practices and an underdeveloped private sector likely to reduce the positive impact of investment on the domestic economy. The report therefore recommended five axes for policy reform that were scalable over time, as follows: (i) improve the clarity and predictability of the FDI framework; (ii) improve the general operating conditions for business; (iii) create industry promotion packages in tourism, export manufacturing and herbal products; (iv) enhance the potential for FDI in the medium to longer term by removing bottlenecks in the production of hydropower, addressing sectoral constraints, and moving forward with the programme of privatization; and (v) create a special investment agency to implement reform of the investment framework and promote targeted investments. The main findings for each area are summarized below, and more details are presented in the implementation matrix (section 4).

## ***3.1. Revise the regulatory framework for FDI to improve clarity and predictability***

Nepal has progressed towards improving some aspects of its investment policy framework in line with the IPR recommendations. Key improvements are the inclusion in the new Foreign Investment and Transfer of Technology Act of 2019 (FITTA) of provisions on national treatment and non-discrimination of foreign investors, the regulation of investment screening procedures with the possibility of appeal, and the establishment of a one-stop shop (OSS) in 2019. The OSS aims to facilitate permitting and other business procedures for new investments.

On the other hand, the comprehensive screening of all investments continues to apply and new entry restrictions (both in terms of activities and size thresholds) were imposed. The authorities have indicated that the list of sensitive industries and the revised minimum threshold for FDI were determined considering the existing capacities of domestic investors, the economic needs of the country, the evolution of inflation, past experience with FDI restrictions as well as the Government's own capacity to offer facilitation to FDI projects. They also stressed that consultations with private and public sector stakeholders were held at the ministry and cabinet levels as well as during the process of parliamentary approval. However, the new restrictions and the minimum investment threshold of NPR 50 million (about \$500,000) have provoked great concern among investors. Several stakeholders interviewed during the fact-finding mission consider that the threshold was chosen without adequate assessment of the local capacity to engage in middle-size investments. The measures taken will have to be carefully monitored and their impact assessed regularly to



ensure that they are not detrimental to attracting investment with potential positive impact. The Government should also ensure that they do not deprive the country of a potential stream of SME investment and seed funding for larger projects.

With regards to treatment, the use of capital controls remains an issue for investors. Even if the legislation was revised to reduce the need of approvals for capital transfers, investors still face hurdles and report significant delays for some transactions. Finally, the country's network of bilateral investment treaties (BITs) remains outdated.<sup>9</sup> The authorities are, however, developing a new text for a model investment treaty, and UNCTAD has provided expert advice to better integrate a sustainable development dimension. The text, whose content is in line with the core principles of international investment policymaking, is in its final stage before approval. The Government may wish to explore opportunities to move forward with the modernization of its BIT network based on 10 options, as included in UNCTAD's Reform Package for the International Investment Regime (UNCTAD, 2018a).

### ***3.2. Improve the general operating conditions for business***

The Government has made some reforms in areas that were considered in urgent need of attention in the IPR, but challenges remain. These include:

**Taxation and investment incentives.** The general and sector-specific corporate income tax (CIT) rates have remained unaltered since the time of the IPR, contributing to improve predictability, as recommended in the report.<sup>10</sup> However, the suggestion to remove mandatory levies in the Labour Act that affected the competitiveness of firms was only partially addressed. Since 2003, the number of investment incentive schemes has increased. Several schemes are available for special industries defined as production-based, agricultural and forest-based, and mineral industries, as well as for enterprises located in special economic zones (SEZs).<sup>11</sup> Additional incentives may be included in each yearly budget, a situation that was already signalled in the IPR as contributing to uncertainty. Investors also report coordination issues between ministries over the granting of incentives, which are not always provided despite a commitment from the authorities. The new federal structure of the country has also resulted in additional layers, which need to be integrated into the decision-making process. Important efforts have nonetheless taken place in reforming the tax administration and introducing an online payments system. The authorities have set up one-stop service centres with the goal of providing automated services that increase the speed of tax payments. The centres are also expected to support the automation for the granting of some incentives and other benefits like tax rebates, which several investors reported as problematic during UNCTAD's mission.

**Labour policy and access to skills.** The new Labour Act of 2017 has extended its coverage to a broader range of companies and employees. Although it increased flexibility in hiring, it also raised the costs of social contributions for employers, which disproportionately affect SMEs. Its impact on employment creation is still to be evaluated. Furthermore,



there is no national survey to determine missing skills and no scarce list approach to issuing visas for foreign nationals. The procedures for obtaining a residence visa and work permit have not yet been harmonized and currently need to be applied for separately, although permit costs are considerably lower than at the time of the IPR.

**Corporate governance and commercial justice.** Company law has been updated to better align it with best practice and improve transparency and business facilitation. Progress has occurred with regards to the adoption of modern, international accounting and reporting standards. On the other hand, contract enforcement remains problematic due to the length and poor quality of judicial procedures. Nepal ranked 151 in the relevant latest Doing Business indicator (World Bank, 2019).

**Competition.** The Government enacted a competition law (the Competition Promotion and Market Protection Act of 2007), which excludes many sectors from its scope. Economic activities remain very concentrated (e.g. in transport activities), and there is no independent competition authority.

**Access to land.** Access to land was facilitated through the creation of SEZs and industrial estates (one of each in all seven provinces), but elsewhere restrictions on the size and use of land have increased. This affects the growth of companies outside special areas or covered by an industrial scheme.<sup>12</sup>

**Intellectual property (IP).** The protection of intellectual property rights (for example, patents, trademarks and copyrights) remains a serious challenge. Addressing the problem requires not only the updating of legislation, but also increased capacities to enforce regulations and sanction offenders. Although the situation has not significantly improved since the time of the IPR, an IP Policy has been adopted in 2017 that establishes some priority actions for reform. Furthermore, a new umbrella IP Act incorporating modern international practice and mandating the setting up of an IP office for all kinds of IP related affairs is in the final stage before promulgation. The proposed bill is also in line with Nepal's international commitments in the protection of intellectual property rights and could help address current gaps regarding the enforcement of IP rights.

### ***3.3. Create industry promotion packages in tourism, export manufacturing and herbal products***

**Tourism.** Tourist numbers increased from 338,000 visitors in 2003 to 940,000 in 2017 (UNCTAD, 2005; UNWTO, 2018). However, the country has not succeeded in attracting significant FDI to the sector, with the exception of some notable non-equity hotel investments (see section 2). The sector remains closed to foreign-owned firms for some activities, and no model tourism development certificate for large developers was set up, as recommended in the original report (see section 4). The Government has nevertheless granted some fiscal incentives to hotel owners and engaged in public infrastructure projects to upgrade air transport and rail connectivity, funded mostly through public funds and development assistance.



**Export manufacturing.** Nepal became a member of the WTO in 2004, the first LDC to join through the full working party negotiation process. It thus benefits from special and differential treatment.<sup>13</sup> The country also continues to benefit from duty free access and open borders to India – with some product exceptions – even if these preferences may have been eroded by India's reduction in MFN tariffs and preferences given to other LDCs (i.e. under SAFTA and duty free tariff schemes) (FNCCI et al., 2016). The IPR included the recommendation to leverage these trade preferences through the creation of SEZs and industrial estates, which was only recently considered after the approval of the SEZ Act in 2016. Although feasibility studies have been conducted for over 18 SEZs, only one is operational and hosts a limited number of companies. While FDI in export manufacturing has been increasing for some activities – particularly in cement, paints, beverages, and steel – inflows in the sector remain meagre overall (NRB, 2018).

**Herbal products.** The herbal products sector has continued to grow in importance. The number of manufacturers along the medicinal and aromatic plants (MAPs) value chain registered as members of the Nepal Herbs and Herbal Products Association (NEHHPA) grew from 20 in 2012 to 85 in early 2018. It is estimated that the whole sector amounts to at least 5 per cent of Nepal's GDP (World Bank, 2018). A recent analysis found that the total value of Nepal MAP exports increased almost threefold during the period 2005–2014, with exports to about 50 countries. However, the increment was primarily due to price increases driven by global demand, as the traded volume declined over the same period. Joint support initiatives with development partners have improved the sustainability of production through extension services. However, value addition has lagged, as the absolute value of processed and finished products declined as a percentage of total exports.<sup>14</sup> Despite the mentioned initiatives, the sector has not received the policy attention envisaged by the IPR. Royalties continue to be an issue and access to land was not significantly improved. Finally, a weak intellectual property rights framework and quality certification issues reduce the sector's attractiveness for the most demanding markets. In this context, a recent bill seeks to address existing quality certification problems through improved accreditation.

### ***3.4. Enhance the potential for FDI in the medium to longer term by removing bottlenecks in the production of hydropower, addressing sectoral constraints, and moving forward with the privatization of State-owned enterprises (SOEs).***

The IPR set out a medium to long-term trajectory for investment attraction in Nepal by encouraging hydropower generation, addressing sectoral policy constraints and moving forward with the privatization of SOEs.

**Hydropower.** As of 2018, existing hydropower stations had a total installed capacity of 1.07 GW, which reflects a significant increase since 2003 (NEA, 2019). At present, total production is equally shared between 16 hydropower plants (HPP), two thermal and two solar plants that are publicly-owned, and 17 small privately-owned HPPs. All of



them are connected to the national grid. In addition, another 23 small HPPs provide electricity in isolated areas. The Government has also concluded several power trading agreements for the export of electricity, principally to India and Bangladesh. There are plans to build an additional transmission line with India and one with China, for which feasibility studies were undertaken. The Nepal Electricity Authority (NEA) retains its monopoly on both transmission and distribution services.

**Agribusiness.** In 2003, in addition to land size restrictions, the Government had conflicting roles as a regulator and as an owner of businesses in this sector, and used tariffs, subsidies and statutory price fixing for agriculture inputs in the food and beverage subsectors. These actions distorted market prices in favour of local producers. Since acceding to the WTO, some trade barriers were removed, and the Government is keen to attract investment in agro-processing. However, these efforts were not always successful and new restrictions in some activities will likely have a negative impact on the integration of food value chains.

**ICTs.** The telecommunication sector has grown fast and mobile penetration has significantly increased, reaching over 80 per cent of the population. A number of IT-enabled services now operate in Nepal, including software development and back office functions (Verisk analytics, LinkTree, Cloudfactory, Fuse machines), cultural industries (Incessant Rain), e-commerce (Alibaba), payment and fintech services (Sewa, FI soft), and business solutions and consultancy services (SeeLogic, Thakral Onen). There are also some Nepali IT companies exporting to foreign markets. The Government's investment in research and development (R&D) has likely contributed to this success. However, a lack of progress towards universal literacy and access to the internet reduces the skills pool in this sector, which is compounded by the emigration of some skilled IT labour. To address this challenge, the Government has produced a Digital Framework to promote e-literacy and training. As part of this programme, it is setting up smart schools and computer labs across the country as the backbone of skills upgrading.<sup>15</sup>

**Regional financial services.** For the sector to become export-oriented, the IPR had recommended the abolition of foreign exchange controls, and the creation of specific fiscal and regulatory regimes for offshore financial services. None of these reforms were undertaken, but the financial sector continued to grow through market-seeking FDI, with the help of improved governance for the sector.

**Privatization.** Some factors that prevented privatization in the 1990s remain in place, including that many SOEs were running at a loss or were overstaffed. The only exceptions have been telecommunications and the energy sector, where private involvement has increased. The Government recently passed the new Public-Private Partnerships and Investment Act (2019) and is proposing a renewed emphasis on attracting private capital to invest in ailing SOEs, although major privatizations are not envisioned.



### ***3.5. Create a special investment agency to implement reform of the investment framework and promote targeted investments***

The IPR envisaged an agency to spearhead investment climate reforms and oversee the development of industry-specific promotion packages. In 2011, the Government created the Investment Board of Nepal (IBN), which was mandated to promote and facilitate investment to Nepal for projects over NPR 6 billion (\$60 million) and hydropower projects over 200 MW. Aspects of the Board's mandate and structure are in line with global best practice, such as the strong link with the executive authority and the employment of staff with private sector experience who can cater to investor needs (UNCTAD, 2018b). The Board has been successful in negotiating and facilitating several large investments in the hydropower and cement industries, and provides follow-up and aftercare services to the larger investors it handles. It also undertakes promotion activities and has a mandate to advocate for investors' interests within the Government. However, the creation of the Board only partially addressed the IPR recommendations, as it focuses on a limited number of mega projects and does not track and monitor smaller investments, which could have a broad and more sustainable development impact. This is likely linked to its mandate to handle PPPs, which counters good international practice calling for independent PPP units that can perform auditing and monitoring of performance during all phases of concessions (UNCTAD, 2015). The Board's advocacy function will also need to be strengthened to move forward with business climate reforms.



# 4. IMPLEMENTATION MATRIX

What	Why	How	Status	Findings
<p><b>1. Improve the clarity and predictability of the FDI framework</b></p>	<p>At the time of the IPR, foreign investment legislation was overly restrictive, and approval and screening procedures were unclear. There were also concerns regarding the treatment and protection of investment. For instance, non-discrimination was not formally granted to foreign investors, there were restrictions on transfer of funds, and the FDI legislation was silent on expropriation issues. Furthermore, investors from certain countries benefitted from additional guarantees under BITs. At that time the network was limited to three agreements. Also, local courts were the only option for most investors to settle their disputes with the State.</p>	<p><b>I.1.</b> Reconsider entry restrictions and align them with the country's development priorities.</p>	<p>○</p>	<p>The legal and institutional framework governing FDI has changed with the approval, in 2019, of a new Foreign Investment and Transfer of Technology Act (FITTA). The new act repealed and replaced the previous version of 1992. Whereas the new regime streamlines some establishment requirements, it has maintained several restrictions.</p> <p>A list of sensitive industries now identifies the sectors closed to FDI, for which only technology transfer is allowed. It includes services like management consulting, engineering and accounting as well as travel agencies, but has also been expanded to include animal husbandry, fisheries, beekeeping, fruits, vegetables, oilseeds, pulses, dairy businesses and other areas of primary agricultural production. On the other hand, three activities that were previously restricted are now open to FDI, i.e. beauty parlours, food processing and local catering services.<sup>16</sup></p> <p>Additionally, in May 2019, the Government raised the minimum FDI threshold from 5 million Nepal rupees (NPR) (approximately \$50,000) to NPR 50 million (\$500,000).<sup>17</sup></p>

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What	Why	How	Status	Findings
		<p><b>I.2.</b> Restrict the screening of investment projects to sensitive activities.</p>	○	<p>The transfer of technology continues to require approval by the Department of Industry (DOI), which reduces the attractiveness of non-equity investments. FITTA 2019 describes the required procedures, including approval by either the DOI or the Investment Board of Nepal (IBN), depending on the size of the transaction (see 1.2, below). However, another automatic way is being considered, which is expected to further simplify the approval process.</p> <p>Finally, the FITTA 2019 regulates access to finance by subsidiaries. It continues to require the approval of the central bank, the Nepal Rastra Bank (NRB), but has simplified the approval process.<sup>18</sup></p> <p>Screening continued for all investments and the requirements were made explicit in the FITTA of 2019. It now prescribes that Government approval decisions be made within seven days from the date of receipt of the application, with a possibility to appeal refusals. FITTA 2019 also allows for some flexibility in the use of re-invested profits, which may be allocated to a different activity than the project where profits were realized. Investment proposals are screened either by the DOI for projects up to NPR 6 billion (about \$60 million) or by the IBN for projects over this amount. In the specific case of hydropower projects, screening is made by DOI for projects up to 200 megawatts (MW) and by the IBN for those above 200 MW, regardless of project value.</p>

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What	Why	How	Status	Findings
		<p><b>I.3.</b> Improve foreign investor treatment and protection.</p>	<p>●</p>	<p>A one-window policy for streamlining the investment process is in place, and a one-stop shop was implemented in May 2019. It is meant to simplify company registration and facilitate visa access, foreign currency exchange, environmental compliance, land administration, customs and tax administration as well as access to infrastructure. Its efficiency will have to be assessed.</p> <p>FITTA 2019 states explicitly that foreign investors will be offered non-discriminatory and national treatment, except under certain circumstances specified in the law. In cases of expropriation, due process is mandated in accordance with the Nepali laws. However, common guarantees, such as those related to compensation in convertible currency, are not specified. Still, since the time of the IPR, there have been no cases of nationalization, and expropriation is not a major concern for investors.</p> <p>The FITTA 2019 grants foreign investors the right to repatriate all invested capital, profits and dividends, the payments of principal and interest on any foreign loans, as well as all investments in transferring foreign technology. However, the process involves multiple approvals and bureaucratic procedures that always require assessments by the DOI and the NRB. Investors' concerns have also been raised that transfer approvals can be unpredictable, and some may take up to one year to complete.</p>

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What	Why	How	Status	Findings
				One bilateral investment treaty (Finland) was signed (2009) and ratified (2011) since the IPR was undertaken, while the three BITs existing in 2003 remained in force. An investment promotion and protection agreement was signed with India in October 2011, but the agreement was not ratified by the Government of Nepal, and was eventually terminated by India in 2017. Nepal is working on a new model treaty with a view to strengthening the sustainable development dimension of its BITs network. Nepal has been a respondent in one known case of investor-State dispute settlement (still pending).
<b>2. Improve the general operating conditions for business</b>	<p>In 2003, the IPR noted that the general operating conditions for business in Nepal created serious impediments to investment. They were also detrimental to enterprise development. The following issues were of special concern:</p> <p><b>Taxation:</b> the regime was burdensome for firms and its administration cumbersome.</p> <p><b>Labour regime:</b> aspects of regulations created distortions that reduced incentives for job creation. Also, the conditions of employment were not the result of consensual tri-partite negotiations.</p>	<b>II.1.</b> Introduce reforms to enhance the competitiveness of the tax regime, increase stability, and improve the administration of tax payments.	◐	At the time of the IPR, general rates of corporate tax seemed reasonable and have been stable over time. The regime included two mandatory levies contained in the Labour Act of 1991: 1) a 10 per cent bonus distribution of gross profit to employees; and 2) an employee housing assistance levy worth 5 per cent of gross income. The Labour Act was revised in 2017 and the housing assistance levy was removed. However, the bonus levy remains in place. On the other hand, various tax incentives are now available to investors, including tax and customs exemptions as well as other allowances. Still, eligible companies are not always able to benefit from them due to budget constraints that prevent implementation by the Ministry of Finance as well as refusals due to arbitrary interpretation of available benefits by tax compliance authorities.

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What	Why	How	Status	Findings
	<p><b>Foreign skills:</b> employing foreigners, in contrast to a flexible business visa system, was overly restrictive and expensive.</p> <p><b>Corporate and commercial law and standards:</b> commercial justice was inefficient and international accounting standards were not in place.</p>			<p>Tax administration is still viewed as cumbersome despite recent efforts to improve it. An online tax declaration and payment platform is in place, as a result of which tax returns can be submitted online since 2019. The system's efficiency will have to be evaluated. Special units providing dedicated, prompt and efficient service were established in 2004 for large taxpayers (the Large Taxpayers Office) and in 2018 for medium-sized firms (the Medium Level Taxpayers Office), in addition to Taxpayers Services Offices in each urban centre. Their goal was to improve the efficiency of tax payments. These reforms did not, however, fully address some of the challenges identified at the time of the IPR, like the backlog for refunds of VAT rebates and customs duty drawback. Private sector representatives expressed concerns that tax rebates and reimbursement of advance payments could take more than a year, despite the Government's commitment that it should take one month. The implementation of the new federal structure of the country, which created additional layers of decision making, has also created challenges for taxpayers.</p>

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What	Why	How	Status	Findings
	<p><b>Competition:</b> Nepal had no competition law or authority regulating anti-competitive business practices.</p> <p><b>Access to land:</b> the size ceilings on land ownership prevented taking advantage of economies of scale for many activities.</p> <p><b>Intellectual property rights:</b> the court system and administrative bodies were ill-equipped to deal with intellectual property issues. While patent and trademark infringements were common, no penalties were imposed.</p>	<p><b>II.2.</b> Update labour regulations, including by creating market-driven incentives to boost employment, encourage tripartite negotiations and multi-stakeholder dialogue, and establish independent dispute settlement mechanisms.</p>	<p>●</p>	<p>A National Employment Policy was enacted, which led to comprehensive legal reforms, including the revision of the Labour Act, the Contribution-based Social Protection Act in 2017 and subsequent by-laws. Basic standards on health, safety and leave allowances were either maintained or increased, including paternity leave, which was not previously regulated. Furthermore, the new social protection rules now oblige employers to provide pension, medical insurance and other benefits. The new framework allows for higher flexibility in hiring by increasing the available spectrum of contract length from two to five types, and by removing the requirement of prior approval by the Department of Labour to dismiss employees in case of restructuring.</p> <p>Tripartite negotiation structures, involving unions, employers and Government, were also expanded. A Minimum Wage Fixation Committee hosted by the Ministry of Labour has been set up in 2017 and will determine minimum wages through tripartite consultations every two years. However, enforcement can be an issue due to limited capacities of labour inspectorates to monitor implementation in the context of federalization reforms.<sup>19</sup></p>

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What	Why	How	Status	Findings
		<p><b>II.3.</b> Facilitate access to scarce skills by improving the administration of work permits for non-residents, including by reducing fees, adopting a scheme for key personnel and facilitating visa renewals.</p> <p><b>II.4.</b> Strengthen corporate governance and commercial justice, by introducing modern standards and increasing the efficiency and predictability of courts.</p>	<p>○</p> <p>◐</p>	<p>Whereas labour dispute resolution was not the focus of recent reforms, independent arbitration for collective disputes is now mandatory under certain circumstances (e.g. for entities providing essential services, for entities established in special economic zones (SEZs), and in a state of emergency declared in accordance with the Constitution).</p> <p>The procedure for residence visas and work permits are still not harmonized as recommended by the IPR and the approval process continues to be bureaucratic and slow. Whereas visas for foreign staff may be granted for up to five years — with the possibility of an additional two-year extension — this is not common practice and companies face hurdles to keep their managers and employees after only two or three years of work. This is particularly challenging in the case of young firms. On the other hand, the costs of permits have been significantly reduced compared to the situation in 2003 (ISSR, 2019).</p> <p>The Companies Act (2006) and the Companies (First Amendment) Act (2017) have helped improve corporate governance for example, by introducing protections to company names and clarifying procedures for the deregistration of defaulting companies. Accounting and reporting requirements have also been steadily expanded and improved since the IPR, based on the decisions of the Council of the Institute of Chartered Accountants.<sup>20</sup></p>

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What	Why	How	Status	Findings
		<p><b>II.5.</b> Introduce a competition law and authority to monitor and regulate anti-competitive business practices.</p>	<p>●</p>	<p>However, reports find that the enforcement of contracts remains time-consuming and expensive. Thus, Nepal scores poorly – although not necessarily lower than regional comparators – despite voluntary mediation and conciliation being available (World Bank, 2019).</p> <p>The Competition Promotion and Market Protection Act (2007) prohibits a range of anti-competitive practices, including agreements in restraint of competition, abuse of a dominant market position and mergers with intent to restrain competition. The Act also mandated the creation of the Competition Promotion and Market Protection Board, located in the Ministry of Industry, Commerce and Supplies (MoICS). Its role is to monitor and advise on competition matters. It is also the body responsible for investigating cases and prosecuting alleged infringement in the courts. The Board does not have sanction power, and the courts make final decisions on settlement and the imposing of fines. The Act does not apply to several, and the economy remains very concentrated according to interviewed private stakeholders.<sup>21</sup></p>

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What	Why	How	Status	Findings
		<p><b>II.6.</b> Improve access to land by enabling parcels to be acquired more efficiently for commercial projects and investment in infrastructure.</p> <p><b>II.7.</b> Improve the legal framework and enforcement of patents, trademarks and copyright rights, and align legislation to WTO requirements.</p>	<p>○</p> <p>◐</p>	<p>At the time of the IPR, ceilings on the area of land that any person may own applied, and the Government was entitled to compulsorily acquire excess land holdings. Businesses requiring land in excess of the ceilings would need to obtain government approval. The ceilings on land purchases still exist (11 <i>bighurs</i> or 7.7 hectares) and permission is required to expand above them. Furthermore, purchases of land above the ceilings are granted on the condition that they be re-sold for the same purpose. In addition, mortgaging on excess landholding is now restricted.</p> <p>The new Constitution of 2015 includes IP in the definition of property, and Nepal signed the 1994 WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) when it joined the WTO in 2004. However, the specific legal framework for IP has not significantly changed, and remains narrow. The enforcement of intellectual property rights is weak with widespread infringements of trademarks and copyrights, in particular at the borders. Law enforcement officials do not have adequate training on IP issues, and there is limited awareness among the population about the benefits of IP protection (USICS, 2019).</p>

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What	Why	How	Status	Findings
				<p>In 2017, the Government approved an IP policy that is the foundation for a new legislation. The policy aims to include protection of geographical indications, petty patents, traditional/cultural knowledge, integrated circuits, trade secrets, biodiversity and plant variety protection (WTO, 2018). Furthermore, a new umbrella IP Act incorporating modern international practice and mandating the setting up of an IP office for all kinds of IP-related affairs is in the final stage before promulgation. The proposed bill is in line with Nepal's international commitments in the protection of intellectual property rights, and could help address current gaps regarding the enforcement of IP rights. Moving forward with these reforms will improve the protection of Nepal's genetic resources or medicinal and aromatic plants (MAPs), thus increasing attractiveness to FDI.</p>
<p><b>3. Create industry promotion packages in tourism, export manufacturing and herbal products</b></p>	<p>Given the investment potential in some sectors that could not be realized, the IPR proposed the creation of industry promotion packages. These packages would improve FDI attractiveness and facilitation in the short term in the following activities:</p>	<p><b>III.1.</b> Foster tourism development by:</p> <p>a) Removing the ban on overseas tour operators and travel agencies with ownership of operations in Nepal.</p>	<p>🕒</p>	<p>The restrictions on foreign-owned tour operators and travel agencies are still in place (see I.1). Incremental measures that were suggested in the IPR, like partially opening the sector to major players that have the capacity to enhance the marketing of Nepal as a tourist destination, or encouraging joint ventures, were also not undertaken.</p>

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What	Why	How	Status	Findings
	<p><b>Tourism:</b> although it already played a leading role in Nepal's economy, there was significant potential to further attract investment in high-value niche segments.</p> <p><b>Export manufacturing:</b> the creation of SEZs as well as existing trade preferences (e.g. the Nepal-India trade treaty for instance) could be leveraged to promote industrial growth.</p> <p><b>Herbal products:</b> Nepal had hundreds of plants with medicinal and aromatic properties, which could be further processed for health and cosmetic purposes, thus adding value.</p>	<p>b) Formulating a model tourism development certificate including improved facilitation and targeted fiscal incentives to be offered to investors in significant hotel development projects.</p> <p>c) Designating tourism development zones to address infrastructure weaknesses through various types of PPPs.</p>		<p>No model tourism development certificates were introduced, but some fiscal incentives have been put in place. Accordingly, reinvested profits in the tourism industry are exempt from dividend tax. Industries related to tourism or an international flight operation established with capital of more than NPR two billion (\$20 million) are also granted a 100 per cent exemption from CIT for a period of five years from the start of business activities and a 50 per cent deduction for the following three years.<sup>22</sup> There is also a customs duty exemption during the construction phase of hotels.</p> <p>Private investment in tourism-related infrastructure has not been significant, and no specific tourism development zones were created. However, developing tourism infrastructure remains a priority for public investment. As part of the National Tourism Strategy 2016—2025, which envisages a fivefold increase in arrivals — up to 2.52 million annually by the year 2025 — the Government has initiated significant infrastructure projects aimed at boosting the tourism sector. Key among them are the construction of three international airports (Pokhara, Gautam Buddha and Nijgadh) and a master plan to develop Lumbini (birthplace of the Buddha) as a World Peace City. The Government is also investing to improve rail and road connectivity, financed by a combination of public funds, the Asian Development Bank and other multilateral partners. Whereas the country's vulnerability to natural disasters (e.g. floods, earthquakes) has reportedly been a deterrent to major private investments, the potential for partnerships remains to be exploited.</p>

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What	Why	How	Status	Findings
		<p><b>III.2.</b> Create SEZs for export manufacturing by granting significant administrative autonomy to SEZ administration and set up enhanced industrial estates by private developers, including through PPPs. Both should provide significant infrastructure and facilitation advantages to resident firms as well as ensuring enhanced procedures and approvals at all levels, including taxation, labour and other procedures.</p>	<p>○</p>	<p>The Government adopted an industrial policy in 2010 that envisioned the creation of SEZs and industrial parks. Its goal has been to promote export-oriented industries. A SEZ Development Committee was established in 2013 under the Ministry of Industry to prepare the legal framework and conduct the pre-feasibility and feasibility studies for the establishment of SEZs. In 2016, the Parliament approved the SEZ Act. The benefits of locating in the zones include facilitation of payments of customs duty, excise duty and VAT as well as CIT exemptions. In addition, investors have access to guaranteed electricity and streamlined registration procedures. Being in the zones implies an export requirement of 60 per cent of production (lowered from 75 per cent after an amendment was passed in 2019). Finally, the legal framework prohibits strike action in the zones, which is a case of lowering of labour standards not in line with good international practice (UNCTAD, 2019).</p>

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What	Why	How	Status	Findings
				<p>As of May 2019, only one zone was operational (Bhairahawa), and another one was under construction (Simara). The two zones are in southern Nepal, near the border with India. Although the zones are publicly administered, the Government is considering becoming merely a facilitator/regulator in the future, rather than a developer/operator.<sup>23</sup> Targeted industries include bottling plants, metal processing, polymers manufacturing, food and beverages as well as garments. Over 20 firms have been approved, some of which are already operating in Bhairahawa. In addition to the SEZs, there are 11 industrial districts (IDs) in operation, which provide land and other infrastructure for commercial and industrial use to resident firms. The State-owned Industrial Districts Management Ltd (IDM) has a remit for the management and supervision of all IDs. Since 2016, the Government has planned new estates in each of the seven provinces. Although FDI is permitted, the goal of the estates is focused on rural development through the targeting of domestic enterprises.</p>

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What	Why	How	Status	Findings
		<p><b>III.3.</b> Enhance opportunities for the herbal products industry by: a) granting access to parcels of land to cultivate plant species in a nucleus estate on a commercial scale.</p> <p>b) offering an herbal products investment certificate to investors. The certificate would offer a competitive fiscal regime and incentives in the form of deductions for R&amp;D expenses and the provision of extension services to smallholder growers.</p>		<p>As mentioned in section II.1, except for the CIT exemption of reinvested earnings, no major reform of the fiscal regime has occurred. In the case of herbal products, the situation is compounded by the application of royalties, which may be too high for some products. Also, rates continue to be unstable, as they are re-assessed every three years (UNEP, 2012; FAO, 2018; Kafle et al. 2018; interviews from UNCTAD fact-finding mission). The State-owned Herb Production and Processing Company Limited also remains a dominant market player, which crowds out potential newcomers in processing activities. With regards to land policy, the existing restrictions on land size can also be a constraint for increasing production.</p> <p>Although the Government did not introduce an investment certificate, specific policy initiatives have promoted sustainable agriculture through extension services for the cultivation of plants and the provision of seed plants and seedlings both by private actors and cooperatives. Additionally, several non-governmental associations exist to support producers and exporters (see FAO, 2010; UNEP, 2012).</p>

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What	Why	How	Status	Findings
<p><b>4. Enhance the potential for FDI in the medium to longer term by removing bottlenecks to production of hydropower, addressing sectoral policy constraints, and moving forward with ongoing privatization of SOEs.</b></p>	<p><b>Hydropower (HP):</b> Nepal has some of the world's largest potential for HP generation. However, at the time of the IPR, the HP generation (528 MW) was below one per cent of its potential. The report signalled inefficiencies in public provision, limited export markets and other constraints preventing expansion.</p>	<p><b>IV.1.</b> Unleash the potential of Nepal to become a major exporter of electricity by introducing regulatory reforms to increase efficiencies, encourage more private participation in the power sector, and engage in power trading agreements with other countries.</p>	<p>●</p>	<p>The energy sector has become one of the pillars of Nepal's investment strategy. Increased public and private investments in the sector enabled the Nepal Electricity Authority (NEA), in 2018, to achieve its primary goal of eradicating load shedding from the entire country, including the end to power cuts during peak hours in the industrial sector.</p> <p>One major policy change that attracted investment was permitting the NEA to sign power purchase agreements (PPAs) denominated in dollars. According to estimates by the Ministry of Energy, Irrigation and Natural Resources, about 120 HP projects are being undertaken, including with investments from China, India and Republic of Korea. It will increase production to 2.5 GW.</p> <p>Still, generation capacity is below two per cent of the country's potential. The slow progress of hydropower development is linked to insufficient planning and investment in transmission and distribution capacity, as the NEA remains in control of the national grid and acts as a monopolistic player that crowds out the involvement of private actors. There is also inadequate cross-border transmission infrastructure, which makes it difficult to develop hydropower on a large scale for export (ADB, 2017).</p>

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What	Why	How	Status	Findings
	<p><b>Agribusiness:</b> the expansion of the sector could have a major impact on growth and poverty reduction. The IPR identified improving infrastructure and access to land as well as reducing market distortions by SOEs as pivotal to the growth and development of agro-industries.</p> <p><b>ICTs:</b> selected activities in the digital economy (e.g. back-office processing for medical transcripts processing and insurance claims) could be further leveraged provided there was appropriate policy emphasis on updating the education system to give subjects such as science, engineering and technology greater prominence.</p>	<p><b>IV.2.</b> Remove sectoral policy constraints that reduce the competitiveness of private investments.</p>	<p>●</p>	<p><i>Agribusiness</i> Since accession to the WTO, import tariffs for the sector have been reduced, and some price controls have been removed. However, existing land access restrictions and the decision to close significant primary production industries to foreign firms has reduced the sector's attractiveness to FDI (see I.1).</p> <p><i>ICTs</i> Nepal has increased its R&amp;D spending, which has reached 0.3 per cent of GDP (ahead of Sri Lanka, with 0.1 per cent). With 15 per cent of the population enrolled in tertiary education, 12 per cent of graduates are in science and engineering.<sup>24</sup> Although modest, these figures are impressive for a low-income country that still faces significant challenges to spread ICT access, particularly in rural areas. However, the share of the population using the Internet was still far from universal and the overall ICT development of Nepal remains insufficient according to international competitiveness rankings (ITU, 2017; WEF, 2019).<sup>25</sup></p>

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What	Why	How	Status	Findings
	<p><b>Regional financial services:</b> the establishment of a financial services industry was achievable provided a legal framework was set up and general business climate and infrastructure constraints were lifted.</p> <p><b>Privatization:</b> although privatization efforts were slow-paced, the IPR concluded that privatization could offer some attractive opportunities for FDI in specific industries to increase capital stock and introduce newer technologies and management practices.</p>	<p><b>IV.3.</b> Prioritise SOEs for privatization in those activities where private capital could bring new efficiencies.</p>	<p>●</p>	<p><i>Regional financial services</i></p> <p>None of the recommendations to reform the financial sector in the IPR were undertaken (see I.3). However, in January 2017, the Bank and Financial Institutions (BAFI) Act was enacted. It aims to strengthen corporate governance and reduce potential conflicts of interest by prohibiting company loan takers from serving on the board of a lending bank. Whereas the banking sector is deemed healthy and financial intermediation remains the second largest recipient of FDI, stringent capital controls preclude outward-oriented development of financial services in the short term.<sup>26</sup></p> <p>Telecommunications and energy have managed to attract moderate amounts of private capital, including FDI.<sup>27</sup> On the other hand, the process remains slow-paced, with the last (partial) privatization occurring in 2008 (Nepal Telecom). While the Government is planning to sell its remaining shares in this company, no other significant privatizations are in the pipeline.</p>

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What	Why	How	Status	Findings
<p><b>5. Create a special investment agency to implement reforms of the investment framework and promote targeted investments</b></p>	<p>At the time of the IPR, Nepal had no institutions undertaking investment promotion functions. The report recommended, in the short term, to establish an Investment Agency with limited functions. It would have a remit to implement investment climate reforms as well as designing specific promotion packages in tourism, manufacturing and herbal products (described in III above). The same agency would address investor complaints and advocate for policy change in Government. The remit of the agency should last three years, after which an investment promotion agency (IPA) could be set up with broader mandates and functions.</p>	<p><b>V.1.</b> Set up a new agency, reporting to the highest levels of government, with a twofold mandate. It should lead reforms of the investment framework and also prepare investment promotion packages to stimulate an increase of FDI in a few selected activities. In the longer term, the investment agency could be replaced by an IPA.</p>	<p>●</p>	<p>The Government did not put in place an interim agency of the type recommended in the IPR to promote business climate reforms and selected investment promotion packages. However, some legal reforms were enacted by the MoICS to address business climate concerns (see I and II).</p> <p>In 2011, the Government established a permanent body that undertakes typical IPA functions (i.e. image building, marketing, business intelligence, investor targeting and aftercare, advocacy) – the Investment Board of Nepal. The IBN was created with the mandate to promote economic development by mobilizing domestic and foreign private investment and managing PPPs to accelerate industrialization. As of 2019, the IBN was under the remit of the Prime Minister of Nepal, and its office is headed by the Chief Executive Officer (CEO), who is also IBN's member secretary. It has 16 staff. The agency successfully organized an Investment Summit in Kathmandu in March 2019, which attracted the attention of international investors. However, IBN's success on FDI attraction has so far been limited and a lack of adequate staffing resources may have prevented more intensive targeting.</p>

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What	Why	How	Status	Findings
				<p>Furthermore, given the IBN's mandate to create a business-friendly environment, its advocacy function enhancing public-private sector-dialogue will need to be strengthened by creating institutionalized mechanisms, which will be needed to move forward with business climate reforms (UNCTAD, 2008).</p> <p>Finally, whereas the Board advertises investment opportunities in many activities (e.g. agriculture, banking, education, health, tourism, and transportation), its targeting efforts are focused on promoting large infrastructure projects (e.g. in hydropower, chemical fertilizers and integrated solid waste management), which may not need as much promotional effort as projects in other sectors. This bias may be due to the dual mandate for screening investments by the IBN and MoICS (see I.3), but it has also resulted in a duplication of efforts for some promotion tasks (for example, image building, marketing, and facilitation). Better coordination between the MoICS and the IBN and with other agencies that also undertake investment promotion related activities (i.e. the SEZ authority) will be needed to increase effectiveness.</p>

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# 5. CONCLUSIONS AND THE WAY FORWARD

In recent years, growth in Nepal has been robust and FDI has been on the rise. The Government has undertaken commendable policy reforms to strengthen institutions and close regulatory gaps. There is also a clear commitment to upgrade infrastructure and support skills development to boost productivity and help the country address environmental challenges and adjust to technological change (ADB, 2018). So far, progress has been uneven, with achievements in telecommunications development outpacing much needed improvements in hard and soft infrastructure (e.g. transport, internet literacy).

With regards to the longer-term business climate, to fully benefit from the reforms and foster their implementation, coordination between agencies and public-private dialogue should be strengthened. It is a very positive signal that the Government is open to revise and amend legislation, and that it has engaged private stakeholders in promotion initiatives. But the lack of institutionalised procedures for dialogue and reform has reduced policy effectiveness. Some recent initiatives could help address this gap and bolster public-private dialogue. They include the establishment of an “Advisory Council for Promotion of Industry and Commerce”, a high-level committee chaired by the Prime Minister, as well as plans to establish a “Nepal Business Forum”.

Furthermore, the Government will need to tackle the challenges arising from a lack of capacities and governance issues to ensure that reforms will successfully translate into workable practices on the ground. One example is the OSS and single window of entry for investors. The OSS has just been established, but even before it started operations, investment stakeholders were still uncertain about which procedures it facilitated and how well integrated the system was.

The Government should also better define the role it sees for FDI and its interaction with the domestic economy to improve the predictability of the investment regime and the effectiveness of promotion activities. For example, comprehensive screening, sectoral entry restrictions or thresholds on FDI could be re-assessed. Restrictions on FDI for specific industries would need to be clearly specified and revised regularly to ensure they remain the most appropriate and cost-effective method to achieve development priorities, while preserving a policy of general openness to FDI.

Improving transparency and dialogue will also have an impact on the general business climate, from business registration to competition policy, taxation, access to land and intellectual property, where progress has been uneven. Institutionalising



private-public dialogue could help ensure that legislation remains conducive to growth and sustainable development outcomes, is more beneficial for investors, and minimises negative perceptions about the country's investment climate.

This implementation report finds that the following reforms could help Nepal attract more FDI and increasingly benefit from it:

1. Re-assess the current threshold for FDI entry and set up a mechanism to regularly consider the usefulness of restrictions.
2. Abolish mandatory screening for projects in non-sensitive sectors to reduce the administrative burden of investor entry and facilitate establishment.
3. Expand the mandate and resources of the IBN to become a fully-fledged investment promotion agency that is the entry point for all investments and is responsible for every stage of the investment attraction cycle.
4. Benchmark the OSS, based on UNCTAD's Global Action Menu for Investment Facilitation (UNCTAD, 2016). The Menu aims to align investment facilitation with a broader investment for sustainable development agenda. It includes guidance on how to improve transparency and information available to investors, the efficiency of administrative procedures, enhancing the predictability of the policy environment, increasing accountability and effectiveness of government officials, improving coordination and mitigating investment disputes. UNCTAD stands ready to provide technical assistance on investment facilitation, including to update the iGuide that was prepared in 2013.
5. Revise Nepal's international investment agreements in line with current best policy practices. Nepal has already taken steps to develop a new model BIT. Care is needed to ensure it incorporates sustainable development considerations into specific clauses (for example, those related to the safeguarding of public health and safety, environmental measures, human rights and labour rights, amongst others). Towards this end, the Government could refer to the tools summarized in recent publications (UNCTAD, 2015; UNCTAD, 2018a).
6. Re-assess current incentive schemes (i.e. fiscal, financial or others), including to firms in SEZs, based on their contribution to the fulfilment of Nepal's sustainable development objectives. The Government should consider the long-term costs and benefits prior to implementation, giving due consideration to potential market distortion effects. Ideally, incentives should be targeted at promoting sustainable-development sectors and made conditional on social and environmental benefits. They should be periodically reviewed for their effectiveness in achieving the desired objectives.



7. Undertake comprehensive monitoring and evaluation of the sustainable development impact of SEZs to ensure their benefits outweigh the costs. Such an assessment could be informed by UNCTAD's "SEZ Sustainable Development Profit and Loss Statement" (UNCTAD, 2019). The Statement presents a template for undertaking a cost-benefit analysis covering the SEZ's direct and indirect economic contributions, their fiscal and financial sustainability, technology and skills contributions, social and environmental impacts, support to regional integration, as well as policy experimentation and learning opportunities, amongst other variables. Even if the role and nature of SEZs evolves over time, sustainable development impact should remain the benchmark for Government action regarding SEZs. UNCTAD stands ready to provide technical assistance in this area.
8. Confront the issue of concentration of economic activities and anti-competitive arrangements by revising the relevant legislation in line with international standards. There is also a need to strengthen institutional capacities to better monitor anti-competitive business practices and enforce legislation.



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# ENDNOTES

- <sup>1</sup> See [euromoney.com/article/b1gmkm9c6bh2ml/high-risk-nepal-is-the-number-one-improver-in-euromoneys-risk-survey](https://euromoney.com/article/b1gmkm9c6bh2ml/high-risk-nepal-is-the-number-one-improver-in-euromoneys-risk-survey) (accessed 1 November 2019).
- <sup>2</sup> This report was prepared by Joseph Clements and Ariel Ivanier under the supervision of Chantal Dupasquier, Chief of the Investment Policy Review Section, Division on Investment and Enterprise (DIAE). Overall guidance was provided by Joerg Weber, Head of the Investment Policies Branch, and James Zhan, Director, DIAE. Comments were received from Hamed El Kady, Maha El Masri, Joachim Karl and Massimo Meloni. The data were made available by the Trends and Data Section, DIAE, and research support was provided by Utsav Shah and Irina Stanyukova. Desk research was completed by a fact-finding mission to Nepal in May 2019.
- <sup>3</sup> Per capita gross national income (GNI) rose from \$260 to \$960 between 2003 and 2018, and the percentage of the population living on less than \$1.90 a day fell from more than 46 per cent in 2003 to 15 per cent in 2010 – the latest year for which data are available (World Bank, 2019, available at: [databank.worldbank.org/](http://databank.worldbank.org/)). A recent study found that Nepal’s multidimensional poverty index declined by more than half between 2006 and 2014 (National Planning Commission, 2018).
- <sup>4</sup> World Bank (2019), available at: [worldbank.org/](http://worldbank.org/)
- <sup>5</sup> UNCTAD (2019), available at: [unctadstat.unctad.org/](http://unctadstat.unctad.org/)
- <sup>6</sup> Indian FDI stock in Nepal fell by 66 per cent between 2012 and 2014 (UNCTAD FDI/MNE database).
- <sup>7</sup> Nepal only reports data on equity capital to UNCTAD and does not report on other components of FDI. However, a study undertaken by the NRB contains estimates of other components (NRB, 2018).
- <sup>8</sup> There is no formal industry classification for tourism statistics, but the sector is notionally made up of transport, hotels and restaurants and other services – see UNCTAD (2007).
- <sup>9</sup> Recent research and policy advice have focussed on how to improve the sustainable development dimension of investment agreements (UNCTAD, 2015; UNCTAD, 2018a).
- <sup>10</sup> The general corporate income tax (CIT) rate is set at 25 per cent. Sector specific CIT rates apply to financial services (30 per cent) and selected industries (20 per cent).
- <sup>11</sup> Most available schemes are defined in the Industrial Enterprises Act (sections 22-34) and the Income Tax Act.
- <sup>12</sup> Industries outside industrial estates or SEZs may acquire land if specified in their industrial scheme and the Government will facilitate the acquiring of land.
- <sup>13</sup> Nepal benefits from duty free, quota free market access to some advanced industrialised markets, such as the European Union under the Everything But Arms initiative, and the United States for 77 products (66 garment items) for 10 years, from 2016, under a special regime to support Nepal’s recovery from the 2015 earthquake.



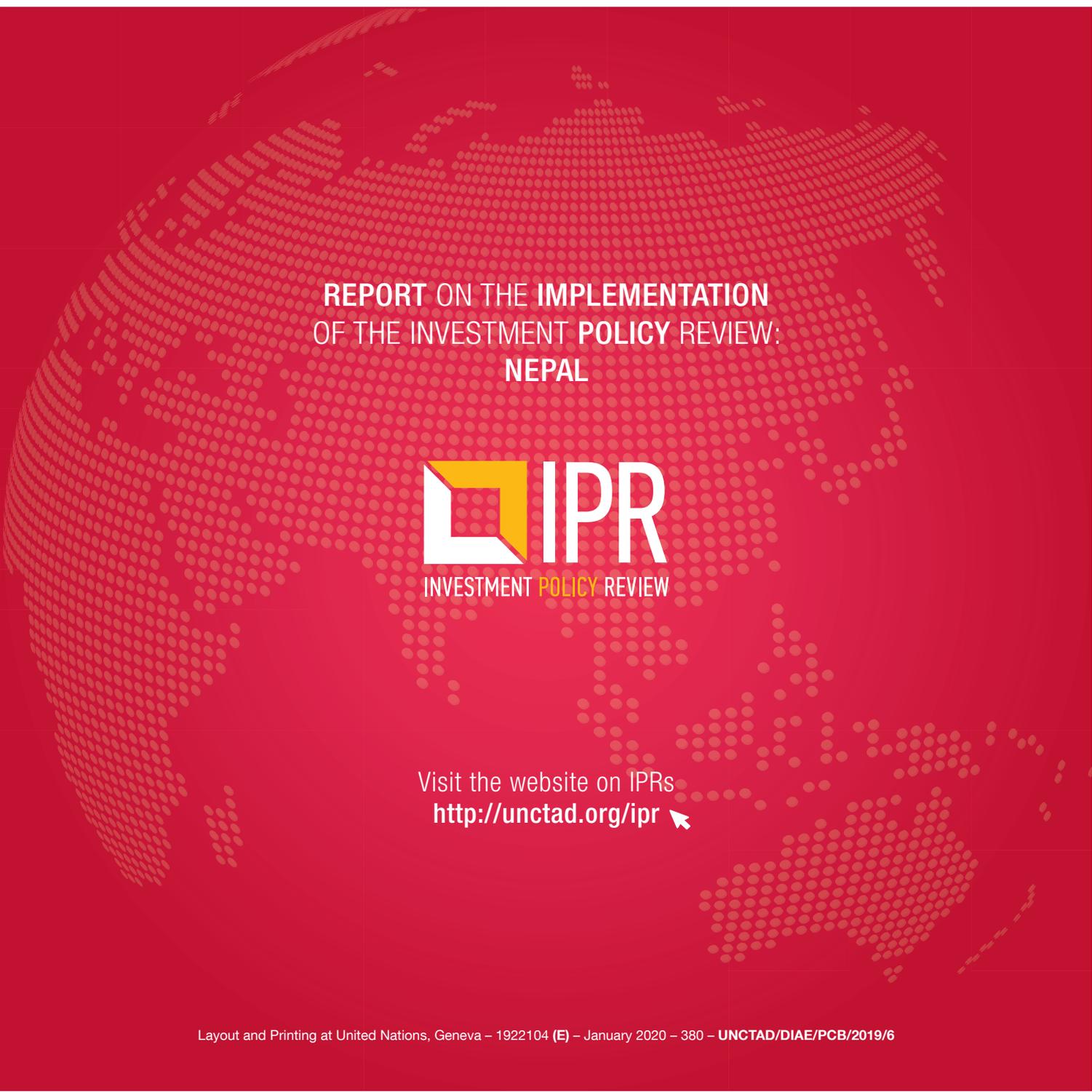
- <sup>14</sup> Exports go to the Indian market (about 90 per cent), followed by China (about 8 per cent) (Ghimire et al, 2016).
- <sup>15</sup> See “2019 Nepal Digital Framework: Unlocking Nepal’s Growth Potential” available at: [nepalindata.com/media/resources/items/15/bEN\\_Digital\\_Nepal\\_Framework\\_V7.2March2019.pdf](http://nepalindata.com/media/resources/items/15/bEN_Digital_Nepal_Framework_V7.2March2019.pdf).
- <sup>16</sup> Further limits on foreign ownership are imposed by sectoral regulations for certain services, such as banking and financial institutions (foreign investment in banking is regulated by the central bank). In this case, foreign investment is permitted as a joint venture with a maximum 85 per cent foreign ownership. For telecommunications, foreign participation is permitted up to 80 per cent. See [investnepal.gov.np/portal/index.php?p1=content&p2=9#.XWTpMugzaHs](http://investnepal.gov.np/portal/index.php?p1=content&p2=9#.XWTpMugzaHs) for more details.
- <sup>17</sup> See [thehimalayantimes.com/business/government-sets-minimum-threshold-for-foreign-direct-investment-at-rs-50m/](http://thehimalayantimes.com/business/government-sets-minimum-threshold-for-foreign-direct-investment-at-rs-50m/) for further details.
- <sup>18</sup> Whereas FITTA allows for the issuing of debt and raising funds in capital markets of a foreign country (conditional on the approval of the NRB and Securities Board), the Act does not address loans from parent to subsidiary companies, a significant component of FDI.
- <sup>19</sup> Federalization involved the creation of a new federal governance structure, with new employers and workers organizations’ committees at the provincial and local levels and an increased mandate of the labour inspectorates (ILO, 2018).
- <sup>20</sup> For example, the Nepal Accounting Standards on the Presentation of Financial Statements (NAS 01) was introduced in 2008. Furthermore, domestic public companies are required to follow the 2013 Nepal Financial Reporting Standards (NFRS), which were prepared on the basis of the International Financial Reporting Standards (IFRS) 2012. The same standards are required for listings by foreign companies. IFRS Foundation, Nepal country profile: [ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/nepal/](http://ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/nepal/)
- <sup>21</sup> The Act does not apply to the following business or trade activities: business relating to cottage and small industries as referred to in the Industrial Enterprise Act, 2049; agricultural products produced by such small farmers as prescribed, and agricultural co-operative business; procurement of raw materials; export business; activity to be done for the labour’s right to collective bargaining; research and development related activity; management collaboration; and collaboration made for organisational and procedural improvements intended to enhance trade capacity (OECD, 2018).
- <sup>22</sup> If capital is increased to NPR 2 billion and installed capacity is increased by 25 per cent, a 100 per cent concession is granted for five years and a 50 per cent concession for an additional three years on income generated due to increased capacity (IBFD, 2019).
- <sup>23</sup> See [seznepal.gov.np/content.php?id=6](http://seznepal.gov.np/content.php?id=6) (accessed 9 July 2019).
- <sup>24</sup> Instead Global Innovation Index 2017, available at: [insead.edu/sites/default/files/assets/dept/globalindices/docs/GII-2017-report.pdf](http://insead.edu/sites/default/files/assets/dept/globalindices/docs/GII-2017-report.pdf).



- <sup>25</sup> The Government estimates internet access to be about 55 per cent of the population as of 2018 ( Government of Nepal, 15th Plan Approach Paper, available at: [npc.gov.np/images/category/15th\\_Plan\\_Approach\\_Paper2.pdf](http://npc.gov.np/images/category/15th_Plan_Approach_Paper2.pdf), accessed 1 November 2019). However, international rankings like ITU's ICT Development Index of 2017 and the WEF's competitiveness report of 2019 provide lower estimates (i.e. respectively 15 and 35 per cent).
- <sup>26</sup> As of December 2018, there were 28 commercial banks, 33 development banks, and 24 finance companies registered with the NRB. This total does not include micro-finance institutions, savings and credit cooperatives, non-government organizations (NGOs), and other institutions, which may function as banks and financial institutions (BFIs). US Investment climate statement, available at: [state.gov/reports/2019-investment-climate-statements/nepal/](http://state.gov/reports/2019-investment-climate-statements/nepal/)
- <sup>27</sup> Indeed, telecommunications is one of the most liberalized sectors in the country and is significantly open to foreign investment (see I.1). As of 2019, there are six principal telecommunications network operators, with Ncel (a subsidiary of the Malaysian AXIATA mobile group) and Nepal Telecom (majority publicly-owned by Nepal Doorsanchar Company Ltd.) covering 95 per cent of the market. See Nepal Telecommunications Authority, available at: [nta.gov.np/en/](http://nta.gov.np/en/)







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