

## **Barriers and solution for better investment climate in Nepal**

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### **ABSTRACT**

The main objective of this paper is to assess the current investment climate in Nepal and to demonstrate the rationale for a competitive business environment. In this process, we document the details of the key features of the investment barriers considering the policy contexts and proposed legal changes in the relevant sector. Further, we present a brief discussion of Nepal's institutional readiness to implement and enforce the emerging improved legal framework including the institutional set up, human resource to facilitate timely labor disputes resolutions, issues surrounding operational for businesses, and foreign investment. We, in this paper, urge to build a wider Buddha Lumbini circuit as a strategic development path that would contribute to improve the investment scenario with collaboration of many countries that have a substantial impact of Buddhism. This would be helpful to attract many tourists, and it would also help to build heavy infrastructure focusing on connectivity issue connecting with the potential industrial hubs in the country.

**Keywords:** Business environment, investment, institutional reforms

**JEL Code:** M29, E22, P11

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### **1.0 INTRODUCTION**

Creating a favorable business environment is a crucial issue as Nepal is transforming its economy to achieve higher, more inclusive and sustainable growth. Nepal aims to graduate to developing countries by 2022 and a middle-income country by 2030. This ambition seems difficult without gaining the business confidence in the economy. As discussed widely in the literature, progress toward political stability and continuing effort to bridge infrastructure deficiency in the country are two pre-requisites (Alesina, *et. al.*, 1996). Building a dynamic market-based economy to propel

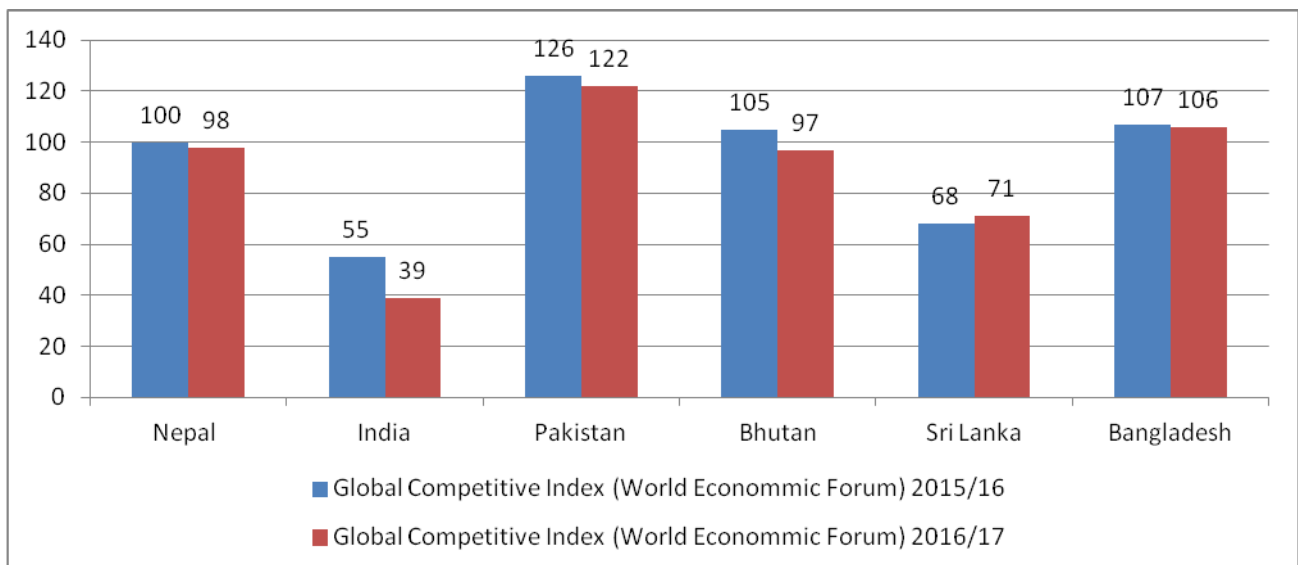
growth also requires a competitive private sector, which in turn calls for an improved business and investment climate (Shelby, 2008). In recent days, Nepal has made some progress especially with legal changes and elections for the long term political settlement, but much more remain to be done.

Nepal stands at the crossroads with a highly expected vibrant private sector amidst increased globalization drive and competition going on (Ramady, 2010). Even in this era of the globalization, unlike in the advanced economies, private sector is losing its confidence in the least developed countries like Nepal (Paudel, 2014). The culpability for this goes to its unavoidable political bickering, insecure labor relations and provisions, weakening bureaucracy, poor access to finance and lack of reform initiatives to spur entrepreneurship development. Innovative approach to create an enabling investment environment is still missing. Moreover, the most cumbersome part is that the policies are hanging in a balance and not fully implemented, resulting in a sense of skepticisms for investors due to procedural delays. With these visible indications, daunting challenges in the investment front remain (Sahoo, 2006).

Investment climate is composed of many dimensions that help in creating opportunities for investment, growth of firms, employment in the product market and, infrastructure services (Gabi, et. al. 2012). Legal and regulatory framework including institutional issues matter greatly in creating investment environment. There is still a gap in trust and understanding between the public and private sectors in Nepal for which public-private dialogue (PPD) would be an effective mechanism to prioritize and promote reforms that will ultimately boost investment environment through institutional reforms and trust building (Bettcher, et al -2015).

According to the global competitiveness index framework, 12 pillars are taken for measuring the competitiveness of 140 countries – in terms of investment and economic growth. Of the 12 pillars, four pillars sub-indexed such as institutions, infrastructure, macroeconomic environment, health and primary education are taken as factor driven basic requirements in the economy (five pillars are mentioned here). Other five pillars namely efficiency enhancers are higher education and training, goods market efficiency, labor market efficiency, financial market development, technological readiness and market size. Similarly, the remaining two pillars focused on - innovation and sophistication factors which include business sophistication and innovation. Based on such pillars, competitiveness of economies is measured.

**Figure. 1:** Global Competitiveness Index



Source: (WEF, 2016).

In South Asia, heavyweight economies are India, Pakistan and Bangladesh surrounded by three smaller economies namely Bhutan (97<sup>th</sup>), Nepal (98<sup>th</sup>) and Sri Lanka (68<sup>th</sup>). According to the

Global Competitiveness Index (GCI) 2017 published by the World Economic Forum, the quality of infrastructure has improved substantially in India (55th), Bangladesh (106th) and Sri Lanka (68th). However, the infrastructure quality deteriorated in Nepal and Pakistan (WEF, 2016). The report also mentioned that Pakistan is the only economy in South Asia failing to improve macroeconomic environment, and health and primary education level. Furthermore, financial market development remains poor in all South Asian countries, according to GCI 2017. Sri Lanka overtook India to become the best performer in technological readiness in the entire region (Figure 1).

If we examine the indicators, India leads in South Asia as it climbed to 39<sup>th</sup> rank - in the year 2016/17 with improvement across the board. Nepal (98<sup>th</sup>) and Bhutan (97<sup>th</sup>) need to improve infrastructure development and connectivity. However, Bhutan, due to heavy investments in hydroelectric power, can rely on electricity supply that helps in investment generation. Pakistan was regularly affected by the climate of instability - expediting economic development (WEF, 2016). Nepal shows worst performance in South Asia in terms of business sophistication, innovation, technological readiness, and infrastructure development.

In Nepal, common phenomena like *bandh* (blockades), strikes, shortage of raw materials, labor issues, short supply of electricity and energies, and difficulties to ensure access to external market due to geographical barrier, have posed challenge to run industries to their full capacities. This has produced negative impact to investors at home and abroad. Study shows that average direct cost of general strikes stood at NRs. 1.8 billion per strike per day and NRs. 27 billion per year as per the research conducted during 2008-2013. The loss from strikes has decelerated annual GDP growth rate in Nepal ranging between 0.6 to 2.2 percent point between 2008-2013 (Shrestha and Chaudhary, 2013)

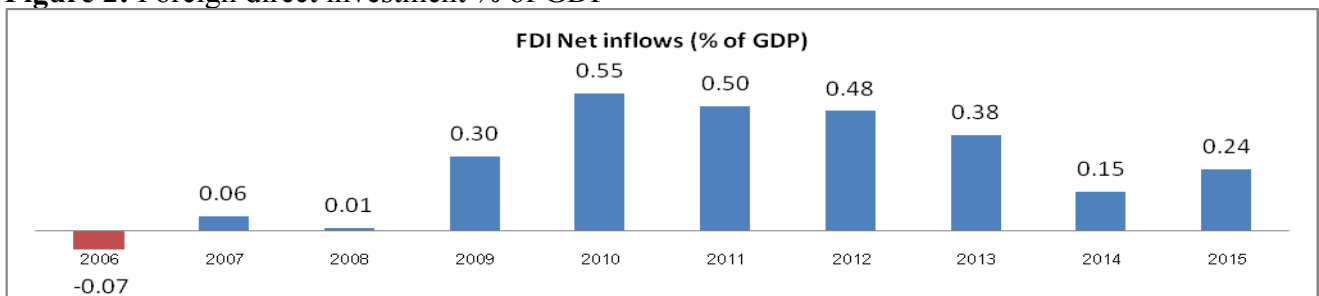
As India is the largest trade and foreign investment partner of Nepal, signing a bilateral Investment promotion and protection agreement (BIPPA) in 2011 is likely to start a new trend for resolving investment disputes in an innovative way. BIPPA is important to international investment law and helps to instill confidence in foreign investors for Nepal. This trend guarantees the rights and security of foreign investors. Both countries are obliged under the treaty to treat foreign investments the same as a domestic and third-party foreign investments, and to accord non-discriminatory compensation in case of nationalization or expropriation of investment (Subedi, 2013).

This paper is organized. In second section, we discuss on current scenario of Nepal's investment and trend. Then, we move to review current policies context that directly impact to the investment in section three. Section four covers barriers for doing businesses and section five concludes.

## 2.0 TRENDS IN PATTERNS OF INVESTMENT

Various problems related to starting a business, entry and exist hurdles, repatriation of income, the lack of progress in attracting foreign direct investment (FDI) to Nepal. The growth of FDI did not meet has been unable to meet the investment needs of the country. However, there are potentials in manufacturing, services and infrastructures sectors.

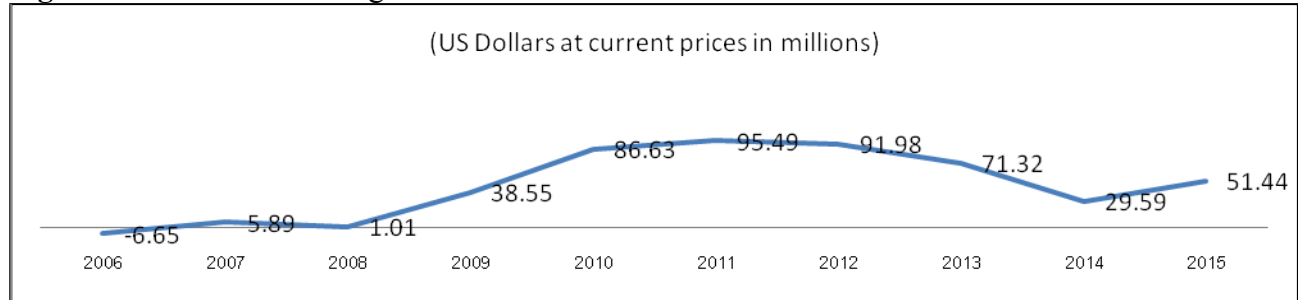
**Figure 2:** Foreign direct investment % of GDP



Source: (UNCTAD, 2017) .

The overall trend of FDI inflows in the country for the past 10 years seem to be in a fluctuating trend. The inflow in 2006 was registered negative that stood at 0.07 percentage of GDP, while it was high in 2010 which was 0.55 percentages, but it seems still very negligible compared to its neighbors. In the year 2015, the contribution of net FDI inflows to GDP went down to 0.24 percentages. This has substantially attributed to the deteriorating investment climate of the country.

**Figure 3:** The trend of foreign direct investment in value



Source: (UNCTAD, 2017) .

In figure 3 above, the value of FDI net inflows in US dollar in the year 2015 stands at \$51.44 million, however, in the year 2011 it was quite up. There is a fluctuating trend in FDI net inflows. In the year 2011, the FDI inflows reached to US \$95.49 million. The reasons for downward trend of FDI net inflows has been attributed to various reasons associated with investors' confidence, facilitation, security, environment and procedural difficulties. In the figure 2, it shows that during 2006 there was a huge capital flight amounting to US \$6.65 million. In the year 2011, there was euphoria in the country and foreign investment was in its peak, as all the major political parties reached an agreement to draft the constitution. This shows that political development makes an impact on economy.

Landlockedness—the geographical situation without direct access to sea is one of the deterring factors for economic growth, as this constraint imposes exogenous costs on Nepal's international trade (Paudel, 2014). Nepal is no exception; in such a context, attracting investment is a challenge, especially, the issue of transportation should be a priority. Access to seaport seems critical when it comes to finding bigger export markets for the produced goods. Addressing these concerns will help investors to invest here and do business on a sustainable basis.

Over the last 5 years, the agriculture and forestry sector show an increasing trend in the contribution of GDP in the form of capital formation (see table 1). The sector components where investment is made, under the agriculture and forestry, are irrigation, land improvement, equipment and other required items. The manufacturing sector (as the investments are made in the components such as construction equipment, software development, etc.) had higher capital formation more than agriculture from FY 2010/11 to 2012/13 and had an increasing trend until 2014/15. However, starting from 2014/15, its gross fixed capital formation of the total GDP seems to be less than that of agriculture and is on a declining trend. Similar trend is reflected by hotels and restaurants, as it had an increasing trend till 2014/15 and then declined in 2015/16.

**Table 1:** Contribution of key sectors as a percentage of GDP in capital formation

Sector	2010	2011	2012	2013	2014	2015
<b>Agriculture and forestry</b>	2.21	2.13	2.35	2.64	3.13	3.2
<b>Manufacturing</b>	2.53	2.41	2.4	2.27	2.51	1.54
<b>Electricity gas and water</b>	1.9	1.87	1.76	1.85	2.05	2.00
<b>Transport, storage and communications</b>	2.8	2.73	3.22	3.69	4.48	4.4

<b>Hotels and restaurants</b>	1.5	1.43	1.59	1.53	1.76	1.24
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Source: (Nepal, 2017).

There is a slight up in the year 2015/16 which stands at 3.2 percent of the GDP compared to 2.21 percent in 2010/11. When it comes to investment in manufacturing sector of the total GDP, it has gone down to 1.54 percent of GDP in the year 2015/16 compared to 2.53 percent back in 2010/11. This trend of investment shows that investment environment is being deteriorated day by day in the manufacturing sector. Nepal's manufacturing sector is suffering from weak infrastructure, especially roads and electricity and protracted political transition that has affected for policy stability. There is an increasing growth in investment in the transport, storage and communication sectors that stand at 4.4 percent in 2015/16 compared to 2.8 percent in 2010/11.

The lack of basic infrastructure, such as, electricity, smooth transportation facilities and access to finance are major deterring factors for sound investment climate. In addition, different enterprises are getting affected by the lack of comprehensive approach to address legal, regulatory, procedural and institutional barriers which have eroded the environment for investment. Due to weak investment environment, investors – both local and foreign took least interest in the country. It also affected the business sector's leadership in promoting the country's economy. The concept of venture capital is yet to take shape in Nepal's business sector.

### **3.0 POLCY CONTEXT**

#### **3.1 Economic Reform**

Though there are policies that were designed to boost the investment climate with the first-generation reforms, but unfortunately, the implementation has been utterly poor, and outcomes are really frustrating. Anomalies in policies are also major constraints that have affected businesses by converting provisions/laws/acts in one's favor and had been misinterpreted. Implementation of policies has been a key constraint for attracting and increasing investments. Politically, the country seems to be moving fast but many things need to be done for the economic development. The bureaucracy is yet to be mobilized in a businesslike manner, according to the private sector stakeholders. Investors see that economic agendas are not being discussed at the political and bureaucratic levels which affected private sector interests.

If the State wants to create confidence among investors, there is a need to reform the legal requirements of the country. The issues relating to the protection of investors' rights, market access of the products, institutional set up to facilitate investors and administrative mechanisms play a critical role in sending good message to investors. Strong legal provisions are required when it comes to encouraging investments.

The causes for deteriorating investment climate in the country are legal, institutional and policy-related overlapping and often contradictory laws and institutional arrangements, differing priorities of various agencies of the government including with serious gaps between policies and their actual implementation on the ground (Adhikari, 2012).

#### **3.2 Foreign Investment and Technology Transfer Act, 2073**

The Foreign Investment Act 2017 (being proposed to table at the parliament) has some provisions for discretionary powers given in the name of 'competent officer'. This has been greatly opposed by the business sector as it creates an environment where the official can take decisions to serve their interests. It should be institutionalized, and institution/ministry should be responsible not the individual for disseminating good messages to investors. Even for the exit, if government officers discretionary authority it is an indication for the investors that the government does not want to create certainty in the investment front.

The incentives provisions mentioned under the 'One Stop Service center' are not clearly defined; they need additional clarification as to how investors will receive their financial incentives. Additionally, giving incentives only to foreign investors won't be fair vis-à-vis domestic investors.



Moreover, what is worrisome is the weak monitoring mechanism by the government in the implementation of laws related to FDI. Industrial Enterprises Act does not differentiate between the local and foreign investors. For example, according to the labor act, implementation of housing provision and central welfare fund are not properly monitored by the authorities as they are applicable for both the domestic and foreign investors. In the case of safety rules in the organizations, there are no safety inspectors to carry out such inspections, as shared by entrepreneurs. Inspections from the Department of Industry (DoI) need to be carried out more effectively.

The issue of investors' rights is critical to attract foreign direct investment. Repatriation of earnings, equal treatment, most favored nation treatment and provision against nationalization hold no lesser significance as these directly to foreign investments. Every new business needs time to generate profits, if the company established under the parent organization is generating profit, then the profits should be allowed to be transferred to the new sister organization as it incurs losses during the initial years. This provision should be materialized effectively, which is now difficult to change. Despite a provision in the law, due to its wrong interpretation, existing provisions are not implemented properly, according to foreign investors associated with MNCs. Even other countries have this provision but in Nepal it is not practiced. Thus, foreign investors who are interested to increase and diversify investments under the existing enterprise are not able to do so due to misinterpretation of laws. This is going to discourage investors to increase their business ventures.

FDI policy of 2015 has some restrictions on few business sectors, such as micro enterprises and traditional cottage industries, arms and ammunition, gunpowder and explosive production; currencies and minting industries, security printing; real estate business; retail business with multi-brands investment less than five hundred million rupees in fixed assets in Nepal; tourist guide, trekking and mountaineering guide; poultry farming, fisheries, bee-keeping, and priority products of agriculture sector; industries relating to radio-active materials; and broadcasting media of mass communications (newspapers, radio, television). Outside these exempted sectors, the law is flexible and liberal policy approach on FDI inflow including the smooth implementation of bilateral and multilateral agreements.

### **3.3 Labor law and its status**

The labor market is a critical area for improving business environment in any country. The labour market regulation/simplification is also one of the indicators for maintaining sound relations between workers and employers. Nepali business sector also concludes that labor and employers' relation was not as bitter until two decades ago, according to MNCs. It seems to be maintaining well. Portugal, Netherlands and Myanmar improved their labor market regulations, according to Doing Business Report 2017 of the World Bank. That has further helped in improving environment for doing businesses, and also helped in sustaining industrial relations.

Capital and labor both move hand in hand and boost for more productive firms in different sectors that ultimately create more jobs. It is noted that reforming barriers to entry can spur the creation of new formal firms and enable exiting informal firms to join formal sector and more jobs will be created.

The proposed Nepal's Labor Act 2017 which is under discussion in the Parliament talks about making the business environment better as it has been clearly mentioned in the preamble that sound industrial relations is very important to develop by ending labor exploitation of all sorts to enhance productivity, protect the rights and benefits of laborers and employers. Employers cannot discriminate workers based on gender, religion, origin and language. There should not be discrimination between male and female workers (recognize equal value of work) when it comes to incentives. Workers are also given rights to form trade unions, operate and take membership as per the proposed Act.

Implementation of existing labor act is a big problem for creating industrial relations in the country. Even the new one, if implemented, would help in improving investment climate, according

to trade union representatives. According to workers, even minimum wage is also not implemented completely, in such a context, there are skepticisms for implementing new Labor Act as well which is being debated in the parliament. The Social Security Fund Regulations which is now in parliament will address some issues concerning workers' benefits such as Welfare Fund, Bonus Fund, holidays and gratuity. Even in the existing provision at the Social Security Fund Regulations, workers are contributing one percent of their total salary for more than six years but employers are not contributing. Of the total profits of enterprises, 10 percent should be earmarked in Bonus Fund but that is not implemented even today.

Workers who work with more than one employer as a part time staff, can also be availed gratuity, provident fund and social security benefits for which employers need to contribute accordingly. The Labor Act has clearly stated that workers would not be forced to work more than office hours, and if needed, additional incentives to be given. As per the new proposed Labour Act, the worker gets contract letter from the day one. If employers are not satisfied with the performance of the employees, they can fire the employees, and the provision of making employees permanent after 240 days work has been scrapped. The proposed Labor Act has also made a provision to raise issues and file a case at the court related to benefits, security, health-benefits, employment related issues, in case of disputes and not resolved through negotiations.

### **3.4 Other investment related acts/legislations**

Patent Design and Trademark Act is important for the country like Nepal to attract foreign direct investment. It should be implemented effectively. Large international investor would want to see the implementation of intellectual property rights. Trademark is important for any investors because well-known brands must be protected locally for foreign investors.

Foreign entities established in the Special Economic Zones (SEZ) are entitled to repatriate their shares/dividends/interest income in US dollar as per the SEZ Act, which has also been mentioned that enterprises/companies that produce goods/raw materials in the premises of SEZ can avail benefits equal to the benefits received by exporters. One Window system has also been envisaged in the SEZ from which all services/benefits required for the investors will be made available. Issues related to benefits, infrastructure related services, industry registration, renewal and visa, are dealt by the SEZ management from under one room that aims at encouraging investors.

The country has been applauded for producing good laws/regulations, but it fails at interpretation. Foreign investors want proper interpretation and the simplest query of profit repatriation is unclear. Thus, many time, investors face problems through Department of Industries (DoI) and Nepal Rastra Bank (NRB) (lengthy procedures) in repatriating profits and such news and facts pushes away potential investors. Addressing these concerns call for an immediate remedy.

According to the report on "Stakeholder Perception Survey" done by the IFC back in 2012, 34 percent of businesses had decided not to make a major investment because of unnecessary problems relating to complying with government regulations. Therefore, even today, investors are skeptical to invest freely. Adoption of key legal and regulatory reforms measures for creating enabling environment for trade and investment has been found slow thanks to the political transition.

### **4.0 INSTITUTIONAL MECHANISMS PREVALENT IN INVESTMENT PROMOTION**

Institutional mechanisms are a critical part of facilitating investments in Nepal. Role of Investment Board Nepal (IBN), Department of Industries and Nepal Rastra Bank are critical. Once the processing related to investment is done on the part of DoI or IBN, the institution like Central Bank of Nepal authorized institution for repatriation of foreign currency make delays in giving approvals. Even DoI and IBN are government institutions, and they do everything required for foreign investment. The involvement of central bank is unnecessary here that creates additional barriers for foreign investors, foreign associated with MNCs complained (Francois, Joseph; MAanchin,

Miriam; Norberg, Hanna; Pindyuk, Olga; Tomberger, 2015). IBN is an authorized government agency mandated for foreign investments approval in the areas such as fast track roads, hydropower, tunnels, railway line, ropeways, trolley buses as prescribed by the government of Nepal.

Investors depend on state mechanisms to protect and increase their investments. The government agencies, like the Department of Industry, Ministry of Industry, Office of the Company Registrar, Investment Board Nepal, Nepal Rastra Bank, are responsible for investment related matters. However, when it comes to facilitating investments local and foreign investors, the names of these institutions are ignored by investors. Moreover, every change in the government affects each government office. Whoever comes as a new minister or secretary takes several months to understand the functioning of the office and its agencies. The change is so frequent that the investment decision for new or additional investment are affected, because investors get distracted with unstable government (Malesky, 2007). Economic agenda not getting priority in the government adds fuel to the fire.

The issues that impact at the macro level for investment are poor political governance and negative mindset of the bureaucratic staff. It might be surprising that the research conducted by the International Finance Corporation (IFC) back in 2013 has termed Nepali government as an obstacle itself to doing business (Gabi G. Afram, 2012). Government's support is considered only less than 39 percent of the firms surveyed in facilitating businesses for starting a business, access to finance and removing regulatory barriers (Shrestha, 2013).

One of the facilitating bodies and strong institutions to see investment related issues is the Department of Industry (DoI). According to the new Industrial Enterprises Act, one-stop shop to be set up at DoI needs to be operated effectively. There are complaints from earlier One Window Service and even the small issues are not resolved such as 'duty drawback'. Investors even used to face different kinds of problems.

Investors raised the issues of non-functional one-window service (OWS) established at the Department of Industry, weak coordination between government agencies like DoI, Nepal Rastra Bank (NRB) and other agencies for repatriation of dividends, weak institutional set up encouraging discretionary powers to government officials, policy instability, unnecessary roving around ministries for documentation for approval of FDI projects, according to a multinational company established in Nepal.

Another agency is the Office of the Company Register (OCR) which has already gone on-line, but it is not being properly operated. Even if the online system is active, investors should carry the photocopy and submit the documents physically at the time of registration which has been named as burdensome mechanisms for registering a company and is an implementation failure on the part of government.

Initially, OCR does not inform to investors/entrepreneurs regarding submission of audit report to the company registrar office but later, OCR office asks for submitting the same that seems illogical, which the business sector people complained. When the time is over, it recalls and asks for fines, which itself seems unnecessary discretionary given to the OCR officials that creates unhealthy practices. In such an environment, it is a question of who takes interests to register a company and invest. Companies have now and then voiced that OCR should be a facilitator (encouraging investments) and not a regulator (collecting and monitoring fines).

## **5.0 BARRIERS FOR DOING BUSINESS**

### **5.1 Manufacturing Sector**

The manufacturing sector is critical component of the country's economy, particularly for the employment for low skilled and unskilled manpower. Manufacturing industries include jute, sugar, cigarettes, beer, matches, shoes, chemicals, cement, and bricks. Textiles, wearing apparel; fur, and leather & leather products & footwear stand out as export-oriented manufacturers with more than 50 percent of their outputs exported. Others include rubber and plastic product and basic metals. The

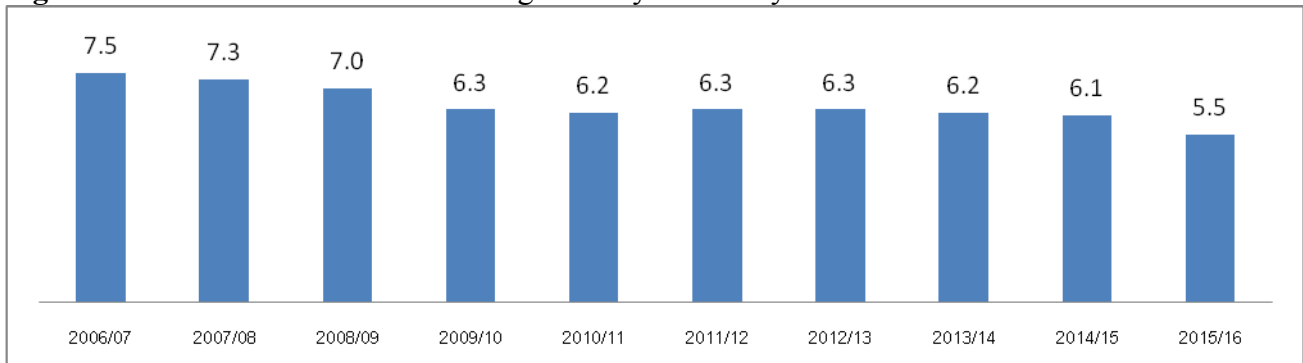


sector contributes about six percent to the total GDP of Nepal. However, this is in declining trend due to various factors such as weak infrastructure, power shortage and lack of facilitation from the government (Canning and Bennathan, 2000). Industrialists are suffering from the lack of skilled and productive human resource, lack of new labour law and increased cheaper imports. This has been a serious issue among the manufacturing units in Nepal.

Manufacturing industry cannot sustain in Nepal as the cost of production and transportation cost is high unless specific strategies are followed to boost this sector. For example, if the raw materials required for manufacturing sector are imported, it costs higher than the finished products, and it seems that the government has all faulty policies when it comes to promoting and boosting infrastructure sector.

Other major issues are power shortage (not regular), open border with India, cheap products imported from India and China which is hard hitting local products to compete in terms of cost. According to the economic survey report for the fiscal year 2015/2016, the share of manufacturing sector in Gross Domestic Product (GDP) stands at a declining from 9 percent in 2000/01 to only 5.53 percent in 2015/16. The share of manufacturing sector in GDP during 2006/2007 was 7.5 percent as per the figures made available by the Ministry of Finance.

**Figure 4:** Contribution of Manufacturing Industry in country's GDP

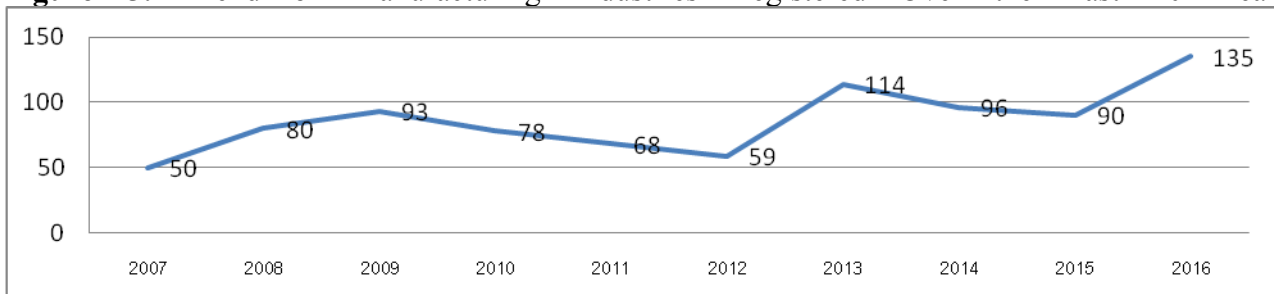


Source: Economic Survey, 2015-16.

Even in the South Asia region, Nepal's manufacturing sector's contribution stands only 6.5 percent of GDP, according to 2012 World Development Indicators.

The record at the Department of Industry shows that in the fiscal year FY 2015/16 about 2,442 manufacturing industries got registered that alone represents 37% of the total industries, with an optimistic note of creating 0.27 million jobs covering 52% of potential employment. This figure cannot be considered real as it is just commitment/expectations of the government.

**Figure 5:** Trend of Manufacturing Industries Registered Over the Last 10 Years



Source: Economic Survey 2015/16.

Registration of manufacturing industries at DoI has been. The figures in figure 5 shows that in the year 2016, there is a highest number of manufacturing units registered over the last 10 years and average growth rate stood at 1.18 percent. However, the performance of manufacturing is found

dismal in the last ten years, all due to unfavorable investment climate in the industry sector, lack of reliable and regular electricity supply, fragile political situation, weakening industrial infrastructures, resulting from lack of sound labor relations and inability to create additional investments by established enterprises.

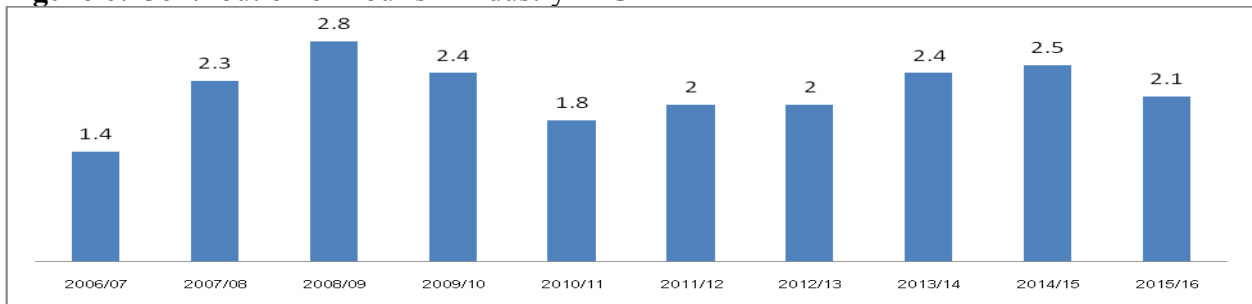
## 5.2 Tourism

The contribution of the tourism sector to the GDP stands at 2.1 percent in the fiscal year 2015/16 which seems similar performance in the year 2007/08 (2.3 percent). Its contribution in 2006/07 was 1.4 percent. The highest contribution, according to Economic Survey 2015-16, the GDP from the tourism sector stood at 2.8 percent during 2008/09. (See Figure 5).

The statistics show that Nepal's tourism sector still does not seem to be moving as fast as the country's requirements in terms of revenue generation. Even investment in the tourism sector during the fiscal year 2015-16 has gone down to Rs. 12,124.9 million from earlier Rs 27,215.37 million in 2014-15.

Investors who are engaged in the sector voiced serious concerns on poor infrastructure like small international airport of Nepal/roadways for the downward performance of tourism sector in Nepal. Inefficient implementation of policies, lack of policy continuity, power shortage, and poor access in finance have hit the tourism sector. However, business sector is yet to be convinced for permanent removal of load-shedding being realized now and are found to be in a wait and see situation.

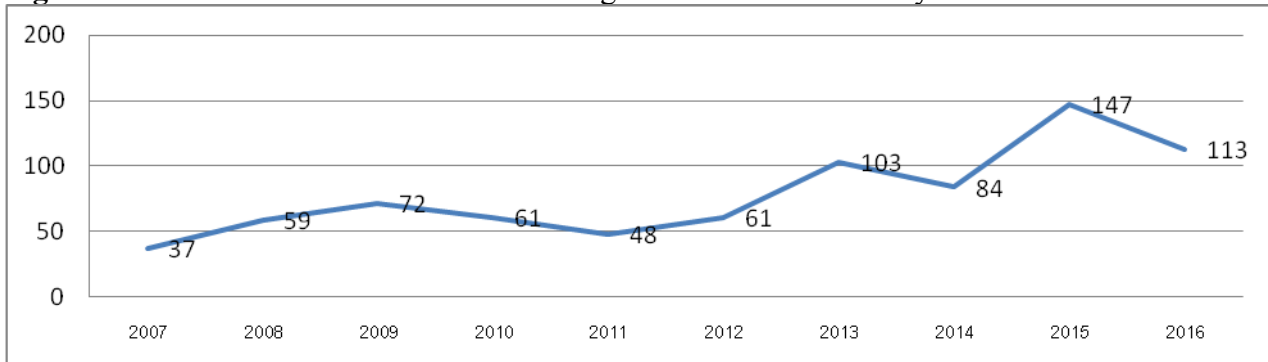
**Figure 6:** Contribution of Tourism Industry in GDP



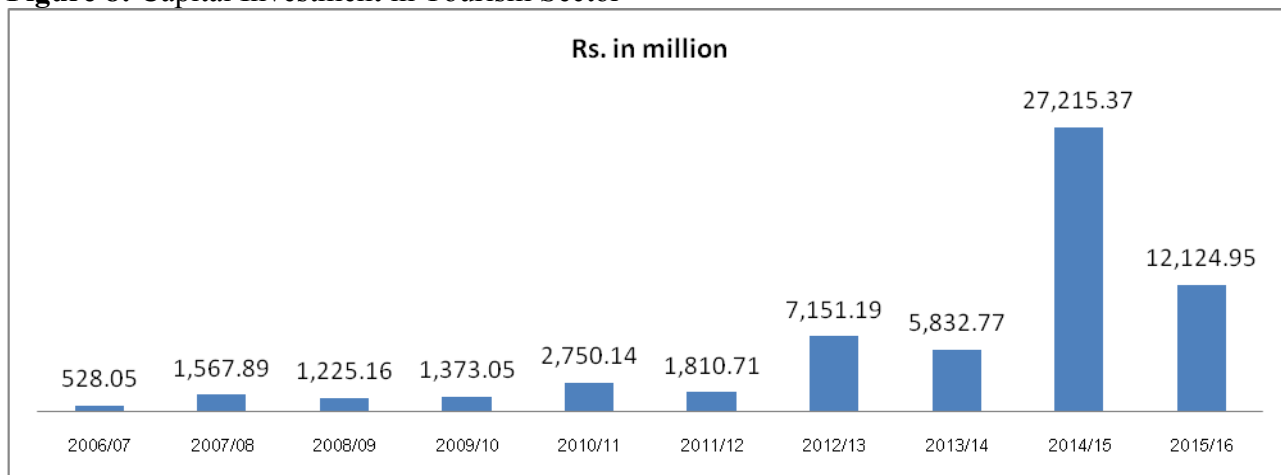
Source: Economic Survey 2015-16.

The records of the DoI reveals that fiscal year 2015/16 about 1,302 tourism related industries got registered representing 20% of the total industries, promising to generate about 53 thousand million jobs covering 10% of potential employment. Compared to 2007 the number of tourism-based industries registered at the DOI has increased but with fluctuation. Fiscal year 2015 saw the highest number i.e. 147 of tourism based industry registered over the last 10 years.

**Figure 7:** Trend of tourism based industries registered over the last 10 years



Source: Department of Industries, 2016.

**Figure 8:** Capital Investment in Tourism Sector

Source: Department of Industries, 2016.

The infrastructure should be strengthened as 28 hotels of 4-5 star hotels are under construction currently, and additional 4000 rooms are being added in the existing 38,000 rooms in total currently in the country, according to Hotel Association of Nepal. Airport expansion, quality enhancement with effective monitoring and supervision encouraging the investors would definitely boost our tourism and generate huge revenues to the national coffers.

The Government announced that 2018 will be observed as Visit Nepal Year. Amidst all these rosy pictures, there are still some urgent issues that need to be resolved and it primarily boils down to our clogged airport, our national carrier's status, similarly packaged products and services, and poor implementation of policies, according to tourism entrepreneurs associated with Hotel Association Nepal (HAN).

Nepal lacks updated technology and system resulting in security and safety concerns, with limited hangers and parking resulting in increased air traffic and longer waiting time on air – basically resulting in upfront bad impression.

Tourists have different choices. Some are for culture; some prefer adventure and some for leisure, etc. Wherever they visit, they need to be welcomed with smile, hygienic food, sound environment, comfortable accommodation and so on. They should be kept away from anxiety, irritability, anger, lack of motivation and focus, restlessness, sadness or depression because tourists have become conscious of health tourism.

Hotel Association of Nepal states that civil servants in India are getting extra money to promote domestic tourism. In Nepal as well, such initiatives may be one way of boosting domestic tourism. In the year 2016, 4.3 million domestic tourists visited different districts which might further increase if new and innovative packages are announced, according to the Hotel Association of Nepal.

The key issues that need urgent attention to promote tourism are as follows. Infrastructure development – expansion of airports, maintenance; branding Nepal at the global level; promote Lumbini as a world's pilgrimage tourism destination, promote heritage development with additional budgets; enhancing the capacity of local travel and tourism sector to go global; upgrading quality of hotels, restaurants, local transport; developing hygiene codes for health and safety, making consistency of electricity and water supplies; focusing on wellness tourism, meditation that support healthy living.

Lumbini, one of the many attractions of Nepal, as a pilgrimage site can attract millions of tourists from across the world. It can be considered as a major tourism site for socio-economic reforms in Nepal as it carries a name popularly known in the world as Siddhartha Gautam was born in Lumbini some 2500 years ago. The concept and devotion that people have over Lumbini are – peace, harmony, meditation, a pilgrimage site for the global citizens. If the Lumbini could be

promoted in line with Buddhist circuit via India and Sri Lanka – it can help in country's socio-economic development and regional economic integration of South Asia. The Buddhist Circuit is an important pilgrimage destination, in the whole of South Asia, for 450 million practicing Buddhists as well as travelers interested in history, culture or religion. Buddhism is practiced in China, South Korea, Japan, Taiwan, Singapore, Vietnam, Cambodia, Thailand, Laos, Sri Lanka, Myanmar, India, Bhutan, and Nepal (International Finance Corporation, 2014). Nepal's potential in linking with Lumbini holds high for which investors from around the world can come to develop infrastructure through Buddhist Circuit for which environment is highly required.

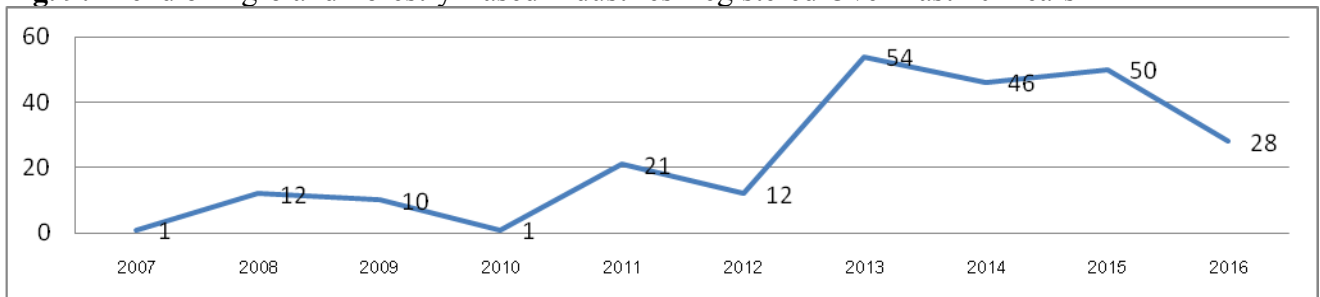
### 5.3 Agro-business Sector

Agriculture sector of Nepal is the mainstay of the economy. According to economic survey for the year 2016, it contributed 32.2 percent of GDP in the fiscal year 2014/015. Agriculture being the central livelihood of the people, it is inevitable to ensure food security, enhancing economic growth and reducing poverty by resolving the barriers faced by the sector. It is estimated, that growth of agriculture is going to remain at 1.14 percent.

The Department of Industries (DoI), an agency under the Ministry of Industry (MoI) shows that in the fiscal year 2015/16, about 395 agriculture related industries have been registered representing 6 percent of the total industries, promising to generate about 33 million jobs covering 6 percent of potential employment.

DoI states that over the last 10 years, the lowest number of industry registered is only one (one in 2007 and one in 2010) and the highest number is 54 in 2013. It reflects the poor environment we have even for registering a company based on agriculture. In the year 2016, the number of agro and forest based industries registered were 28.

**Fig. 9:** Trend of Agro and Forestry Based Industries Registered Over Last 10 Years



Source: DOI, Database 2016.

Nepal has potential for agriculture sector development. To materialize this scope, proper environment for the growth of sector is inevitable. However, Nepal does not have accredited laboratory approved by India which is a major hurdle when it comes to exporting agriculture products and government needs to support in this regard. People do engage in agriculture without government support at the local level. In the year 2007, only an agro-based industry got registered as there was a big political change and parliament approved the abolition of monarchy as part of the peace deal with Maoists. In the year 2010, only an agro enterprise got established as the Constituent Assembly (CA) voted to extend the deadline for drafting the constitution.

**Table 2:** Sectoral investment as percentage of GDP

Year	Agriculture	Manufacturing	Services
2010	11	12	77
2011	11	11	78
2012	11	11	78
2013	11	10	79

2014	12	9	79
2015	13	6	81

*Source: Central Bureau of Statistics, National Planning Commission, 2016*

According to the statistics of the Central Bureau of Statistics (CBS), National Planning Commission (NPC), 2016 though the agriculture sector is recognized as a potential sector for growth and poverty reduction, insufficient inputs like fertilizers, developed seeds, research and extension services and, weak infrastructure (like roads and electricity) are found major obstacles for agriculture sector growth. This has affected to increase the economies of scale. The investment in the agriculture sector, as per the above table 2, stands at 13 percent of the total investment, little higher than manufacturing. However, the sector is weak due to deteriorating management skills, and shortage of manpower due to out-migration. This has further hampered in enhancing exports of agricultural products. There is an increased trend of service sector investment that stands about 81 percent compared to the other sectors of the economy.

Investors engaged in the local manufacturing units are getting worried that 'imported' goods are cheaper than the locally produced goods. Raw materials required for agro industry are costlier. In such an environment, how can investors do business in a commercialized way under such policy arrangement? The oil manufacturer which imports crude for producing soybean oil says, "There is no difference to import finished items, and the raw materials." It shows that there is serious policy error which needs immediate correction, if investment climate is to improve and for local agro-based industries to survive.

Nepal's top agricultural exports products are tea, cardamom, lentils, ginger, essential oils, coffee and natural honey, fruit juices, among others. Provided below are the major exported items from Nepal to various countries over the three years period starting from 2012/13 to 2014/15.

**Table 3:** Quantity of agro products' export

	F.Y. 2012/13 (2069/70)		F.Y. 2013/14 (2070/71)		F.Y. 2014/15 (2071/72)		Annual Change % compared to previous year (in terms of value)	
	Qty in Kg	Value 000 Rs.	Qty in Kg	Value 000 Rs.	Qty in Kg	Value 000 Rs.	F.Y. 2013/14	F.Y. 2014/15
Cardamom	5,102,811	3,849,995	4,913,890	4,270,372	2,930,339	3,839,811	10.9	-10.1
Lentils	21,961,195	2,677,319	17,341,147	2,047,632	9,881,288	1,257,962	-23.5	-38.6
Tea	10,708,598	2,043,220	11,395,744	2,029,439	11,142,480	2,006,877	-0.7	-1.1
Ginger	62,843,364	1,332,453	20,415,666	449,901	24,548,657	464,921	-66.2	3.3
Natural Honey	38	21	1,100	176	3,800	726	754.4	312.4

*Source: Trade export and Promotion Center (TEPC), Nepal Government.*

Nepal has not been able to focus its export market due to insufficient production capacity and inability to produce quality products. It also increases standards requirements as per the WTO-SPS provisions, exporters are in a difficult situation which can only be resolved through collaboration between the public and private sector with sufficient resources in place in agriculture sector, according to exporters/producers involved in export trade of Nepal. Complying with the international SPS measures is critical for exporters of agricultural products.

Making arrangements for technology and equipment are required for increasing agriculture production and productivity, skilled human resource, improved seeds and fertilizers, agriculture extension, marketing of products, and maintaining quality and modernizing and commercializing agriculture sector through adequate arrangements of means and resources for irrigation have been challenging tasks (Ministry of Finance, 2015).



#### 5.4 Agriculture business

Agro-entrepreneurs face the shortage of raw materials which have affected their productivity, and technology still sees a far cry for them due to high investment. It has direct impact on the price competitiveness of the products due to high customs duties (almost up to 50 percent customs duties). The imported products are also cheaper compared to locally manufactured ones, such as soyabean oil. The quality issue in the global market has hit agro-entrepreneurs as there is lack of internationally accredited lab in Nepal coupled with other problems, such as lack of electricity and agro-processing centers.

Thus, the sector needs to establish national level accredited laboratories for quarantine checks; develop quality and trained manpower; strengthened database of the WTO related information, products, market; availability of sufficient financial and technical support; serious efforts by Ministry of Commerce to take initiatives in improving quality infrastructure; branding at the local and international level; and simplification of processes for exporting to other countries. For example, Pashmina product, one of the major exportable items of Nepal, has gained momentum after the introduction of collective trademark and its registration in 45 countries such as USA, Japan, Singapore, Hongkong, China and other European countries. The export of Pashmina increased by over 70 percent in 2015 compared to 2010, and importers are taking more interest to buy pashmina manufactured using Changrya Pashmina wool of Nepal. This sector's employment stands around 30,000, according to Nepal Pashmina Industries Association. The product has other strengths such as traditional manufacturing methods, quality, and designs which are found unique in Nepalese products in the niche market. It can handle small high-value orders, has low labor costs and employment opportunities.

#### 5.5 Small and medium enterprises (SMEs) - local and foreign

Small and Medium Enterprises form a large part of the private sector in many countries including Nepal. SMEs are constrained financially with formal access compared to larger firms. SMEs are considered as an engine of growth; however, market imperfections and institutional weakness hamper their growth (Beck and Demircuc-Kunt, 2006) .

In Nepal, Small and Medium Enterprises (SMEs) share in the total industrial's contribution in the total GDP reportedly stands over 90 percent, according to Federation of Small and Cottage Industries (FNCSI).

The Industrial Enterprises Act, 2016 defined small scale industries as industries having fixed assets up to NRs 100 million whereas medium scaled industries are characterized as enterprises having fixed assets of between NRs 100 million to NRs 250 million. These SMEs are limited in resources, capacity, technology and credibility. The table below categorizes the no. of industries registered in Nepal scale-wise and the employment opportunities they have created as of fiscal year 2016/17.

**Table 4:** Number of registered small, medium and large-scale industries

Scale	No of companies	No of employment
Large	856	126,974
Medium	1,482	140,873
Small	4,186	253,966
<b>Total</b>	<b>6,524</b>	<b>521,813</b>

Source: Department of Industries, 2017.

Table 4 shows that out of total 6524 companies registered in Nepal, 5668 happens to be the SME which is 86 percentage of the total industries. Moving forward to the employment aspect, SME provides a total of 394839 employments which comes out to be 75% of the total employment

provided by the SMEs of Nepal. Hence, the fact that SMEs plays a major role in Nepalese economy and the value chain they create cannot be ignored.

### **5.5.1 Major constraints**

SMEs face various problems from registering a business in the Office of the Company register to marketing the products to the customers. It has been very much cumbersome for the interested entrepreneurs to start a business. For example, if a foreign investor is interested to start a business, he/she has to pay the US \$3,000 to \$5,000 as registration charge which is high and time-consuming (takes 3 to 6 months). It takes from 3 to 6 months, to register a foreign investment company at the Department of Industries (DoI), reports an official associated with Biruwa Ventures Pvt Ltd. Technical support is found very much lacking for SMEs that has made difficulties to really build their businesses on a sustainable basis. SMEs gives employment to over 800 thousand people but facilitation from the state to sustain this sector seems nothing, as there are various provisions/regulations being implemented to Nepal as a member of WTO and this sector, is not aware of new issues.

SMEs cannot access loans and start a business and operate successfully is a major hinderance followed by other quantity, quality, and standards issues when it comes to producing competitive products. Cost of production of SMEs products is high due to costly imported materials. Giving technical support to SMEs would facilitate the import, export and minimize the document requirements, reduce the cost of raw materials and transport cost along with technical know-how (Dibrova, 2015). Professional enhancement tools like training on group purchase, transport bound logistics, documental procedures, registration procedures, tax-related training packages should be customized and targeted according to the needs and nature of the enterprise like microenterprise, agro-enterprise, etc. Nepalese SMEs feel that the private sector people do not share the knowledge, ideas and technical know-how among each other due to the fear of competition and the chance of their business being hampered (Shrestha, 2011).

### **5.5.2 Operational Difficulties of SMEs**

Access to finance is one of the major problems that SMEs face. Even if they get loans, they need to pay high-interest rates as these entrepreneurs have limited access to finance. Inadequate infrastructure to SMEs like transport, electricity and skill manpower have affected their sustainability and productive capacity. Access to the market is another major concern for SMEs products in the competitive markets which has been aggravated due to lack of market network/distribution, market survey, low volume of the products, weak branding and weak support from the government agencies.

The bureaucratic hurdles in the case of SMEs promotion still exist. A lot of coordination is required when it comes to the facilitation of SME business in Nepal through various government agencies as there involve complex procedures. Not only that, SMEs lack of technical and professional skills such as experience, exposure, skilled manpower, IT skills have hampered them for efficiently operating their businesses.

## **6.0 CONCLUSION**

The overall economic development of Nepal is not satisfactory mainly due to lack of investment climate. Nepal's private sector faces various hurdles compared to other countries and the facilitation/support from the authorized government bodies seem utterly lacking as per the literature and consultation with many business sector people engaged in small, medium and large enterprises. Poor infrastructure is a key problem in Nepal to boost private sector development and investment. This has been hampered at a greater length due to frequent changes in the political sector and bureaucracy. There is sufficient budget for spending on airport upgrade, roads and improving IT infrastructure but the lacking side is to manage them with appropriate policy. Therefore, stability in

government and improving the capacity of bureaucrats through training, orientation and engaging them into consultations would help improving the country.

Implementation of policies and laws is a major hurdle. There are good provisions in the laws/acts, but implementation is found very weak. Therefore, coordination between ministries and effective institutional framework is critical sound investment (Gwartney, Holcombe and Lawson, 2006). Implementation of laws/policies can only support the private sector and give a sense of security and confidence to do businesses (Basnett *et al.*, 2014).

Private Equity (PE), as an organized institutional investment vehicle, is not recognized under the legal framework of Nepal. Access to finance is a problem for Nepalese entrepreneurs. Even the budding entrepreneurs with great ideas are not allowed to get loans from the bank. The concept of equity financing and venture capital are yet to be materialized for which the government and interested players should work effectively to boost entrepreneurship development. Amendment in the proposed Foreign Investment and Technology Transfer Act (FITTA) is critical as the current provisions gives discretionary power to the government officials for entry and exit of the investors. This provision may lead to discourage investors and won't start business which will send another wrong message to potential investors. It further invites unhealthy environment for the investors. As the implementation of laws is very much lacking, inter-ministerial coordination is urgently needed to be set up jointly as per the circular of the Chief Secretary from the Office of the Prime Minister and Council of Ministers.

We argue that building a greater Lumbini — Buddha circuit within Nepal and covering India, Bhutan, Sri Lanka and China would attract a substantial investment for infrastructure and boost the tourism sector.

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