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## Foreign Direct Investment Flows: India to Nepal since the 1990s

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**A**bstract *This policy brief examines Foreign Direct Investment (FDI) flows from India to Nepal since the 1990s, analysing key trends, challenges, and opportunities. FDI from India has played a critical role in Nepal's economic development, particularly in sectors like hydro energy, manufacturing, services, and infrastructure. The brief explores how regulatory frameworks, political instability, internal security and bilateral relations have influenced investment patterns. It also highlights recent policy reforms aimed at attracting more FDI and fostering a conducive business environment. The brief concludes by offering recommendations to enhance investment cooperation between the two nations, addressing bottlenecks, and promoting sustainable economic growth in Nepal.*

## Introduction

Nepal has the potential to emerge as one of the most prosperous nations in South Asia, given its strategic geographical location and abundant opportunities in sectors such as hydropower, agriculture, tourism, forestry, mining, and human resources. These sectors hold significant promise, offering viable avenues for sustainable development and economic growth. With a young and dynamic workforce, and its position between two of the world's largest economies, Nepal is well-positioned to attract investments that can drive long-term growth, foster innovation, and enhance self-reliance.

Foreign investment is instrumental in driving this transformation by creating jobs, improving labour skills, and promoting innovation. Although foreign aid has historically facilitated Nepal's human and social development, investment in financial resources and technology is crucial for diminishing external dependency and fostering a self-sufficient economy. The democratically elected governments in Kathmandu are also firmly dedicated to transitioning from a low-income to a middle-income economy by 2030, emphasising reforms aimed at attracting increased investments in vital areas such as infrastructure, job creation, and socio-economic development.

Despite the existing challenges, such as the necessity for substantial economic reforms and political stability, Nepal's abundant natural resources and untapped potential position the country for significant growth in the forthcoming years. With approximately two-thirds of the population engaged in agriculture, enhancing productivity in this sector could markedly increase GDP, while the influx of capital would further drive progress. By maintaining a continued emphasis on fostering an investment-friendly environment, Nepal is well-positioned to realise its full economic potential and achieve its long-term development objectives.

## Evolution and Growth of Nepal's Market Economy

FDI is pivotal in the development of emerging economies. Beyond providing capital, FDI introduces technology transfer, management expertise, and access to global markets. Nepal has

responded to these needs by adopting liberal economic policies and offering incentives to create an investment-friendly environment.<sup>1</sup>

The Government of Nepal initiated economic liberalisation in 2002, reinforcing its commitment to attracting foreign investment. The Industrial Policy and the Foreign Investment and Technology Act of 1981 laid the foundation for foreign investment inflows and technology transfer. These policies encouraged a more active private sector role in industrial development. Further initiatives, such as the 1982 Solidarity Ministerial meeting and the 1984 Investment Promotion meeting, promoted foreign investment opportunities in Nepal (**Annexure-3**). Moreover, the current constitution and Nepal's 15th Plan recognise the importance of foreign investment as a catalyst for improving the investment climate.

FDI in Nepal is regulated by the Foreign Investment and Technology Transfer Act (FITTA) of 2019, along with other legislation such as the Public-Private Partnership and Investment Act, the Labour Act, and the Industrial Enterprise Act. The government offers various concessions and incentives, including tax exemptions for export industries, foreign investors' interest income earned abroad, and relaxations for specific industries.<sup>2</sup>

### Factors Hindering Industrial Development in Nepal

Nepal has struggled to attract and sustain foreign direct investment (FDI), a key component of industrial development. The decade-long civil war and persistent political instability have severely undermined its economic prospects. Although there have been efforts to create a more investment-friendly environment, Nepal remains one of the least attractive FDI destinations in South Asia.

In the early 1990s, Nepal attracted significant FDI due to its liberal economic policies, introduced during the 1980s, at a time when India maintained a more controlled economy. However, following India's economic reforms in the 1990s, which integrated its market into the global economy, Indian investors withdrew from Nepal, particularly during the civil war and in favour of India's more stable and attractive investment climate.

Since 2008, China has become a major investor in Nepal. However, data from Nepal Rastra Bank show that India remains the largest source of FDI, contributing NRs. 88 billion. Approximately 96.6 per cent of Indian FDI is concentrated in three key sectors: 42.9 per cent in hydroelectricity, gas, steam, and air conditioning; 35.9 per cent in manufacturing; and 18.1 per cent in financial and insurance services. Indian businesses, particularly in hydropower, have

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<sup>1</sup> "Survey Report on Foreign Direct Investment in Nepal (2021/2022)," Economic Research Department, Nepal Rastra Bank, Government of Nepal, September 2023, [FDI-Survey-2021-22-2.pdf \(nrb.org.np\)](https://www.nrb.org.np/publications/2023-09-22/FDI-Survey-2021-22-2.pdf) (accessed on 22 September 2024)

<sup>2</sup> "Foreign Investment in Nepal A Synopsis 2022," 07 August 2022, Foreign Investment & Technology Transfer Section, Department of Industry, Ministry of Industry, Commerce and Supplies, Government of Nepal, <https://doind.gov.np/detail/132> (accessed on 22 September 2024)

played a crucial role in Nepal's economic development since 2014, with more than 150 Indian companies' active, accounting for over 33 per cent of the country's total FDI.<sup>3</sup>

## Nepal-India Economic Cooperation

India holds a unique position in Nepal's economic growth and sustainable development due to its geo-cultural proximity, open border, accessible routes to the Indian market, robust trading infrastructure, and frameworks such as the South Asian Free Trade Area (SAFTA). India's commitment to addressing Nepal's developmental challenges aligns with Nepal's efforts to address India's security concerns in the Himalayan region, intertwining economic and security issues.

India has been a key player in Nepal's infrastructure development since the 1950s, supporting sectors that have contributed to Nepal's economic growth and reduced its dependency on other countries. India is also Nepal's largest trading partner and the leading source of FDI since the 1980s when Nepal opened its market to foreign investments.

However, the decline in Indian investments since the early 2000s remains a major concern. Despite adopting a new constitution in 2015 and introducing reforms to attract foreign investments, Nepal has struggled to reverse this trend. In response, Nepal has organised several investment summits to entice foreign, particularly Indian, investors. Notably, during the second and third investment summits, special efforts were made to promote Nepal as an attractive destination for Indian investments.

## Investment Trends: India to Nepal

The India-Nepal economic relationship can be analysed across three key sectors: annual aid and development assistance, bilateral trade, and investment. Historically, Indian State-Owned Enterprises (SOEs) were the predominant drivers of India's investments in Nepal until the late 1980s, when economic reforms in Nepal attracted a surge in private sector investments.

However, Indian investments have fluctuated since the 2000s due to various factors, including political instability, civil conflict, and Nepal's changing economic policies. Although there was a resurgence in Indian investments post-2006, following Nepal's peace process, the growth has been inconsistent. While India remains the largest cumulative investor in Nepal, investment flows have not returned to pre-2000 levels.

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<sup>3</sup> "Commerce Wing Brief," Embassy of India, Kathmandu, 21 June 2022, <https://www.indeembkathmandu.gov.in/page/about-trade-and-commerce/> (accessed on 23 September 2024)

**Table 1: Investment from China, India and USA (FY 1998/99-2006/07)**

Fiscal year	Country	No of projects	Total project cost	Total fixed cost	Total working capital	Total amount of FDI	No of employment
1998/99	CHINA	6	2,343.61	2,181.47	162.14	630.05	260
	INDIA	19	1,437.77	943.86	402.14	724.19	1,361
	USA	6	112.65	62.38	50.28	62.02	169
1999/2000	CHINA	4	568.61	390.95	177.66	143.41	1,145
	INDIA	23	623.66	366.81	256.85	243.31	1,628
	USA	10	618.33	512.97	76.09	593.76	320
2000/01	CHINA	15	2,762.55	2,237.95	524.6	705.26	2,315
	INDIA	37	3,076.94	2,048.72	1,028.23	1,281.77	2,524
	USA	7	703.66	597.18	106.48	448.04	309
2001/02	CHINA	12	229.36	135.8	93.56	162.46	597
	INDIA	20	1,882.63	468.52	1,356.32	678.27	1,452
	USA	8	115.27	94.22	21.06	74.28	139
2002/03	CHINA	12	259.62	158.09	101.53	160.48	373
	INDIA	24	909.99	611.6	298.4	504.95	1,065
	USA	6	919.65	815.54	104.11	514.5	811
	CHINA	16	1,001.19	940.71	60.48	181.73	143
	INDIA	10	1,822.11	1,636.46	185.58	1,696.48	1,560
2003/04	USA	4	25.27	19.87	5.4	17.11	70
2004/05	CHINA	7	213.43	144.86		142.31	257
	INDIA	9	578.88	344.86		223.76	2849
	USA	1	116	80		50	650
2005/06	CHINA	16	331.04	173.3		149.44	694
	INDIA	25	1736.77	1314.09		803.99	2039
	USA	5	430	402.5		406	410

Source: *Industrial Statics, Department of Statistics, Ministry of Industry, Governmental Nepal. Nepal India Chamber of Commerce and Industry*

The data presented in **Table 1** highlights India's historical prominence as the principal investor in Nepal, exceeding investments from other countries. In fiscal year (FY) 1998/99, the Nepali government approved 19 Indian projects, a number that increased to 37 by FY 2000/01. However, a decline in investment activity began in FY 2001/02. Notably, Indian investments witnessed a resurgence starting from FY 2005/06, coinciding with the 12-point agreement between the Maoists and seven major political parties of Nepal, followed by the peace process agreement in November 2006. This period marked a significant phase in India's active role in the peace process and restoration of democracy, which likely contributed to the renewed investor confidence from India.

Despite the upward trajectory in investment during the post-conflict period and the Constitution-making process from 2008 to 2015, a decline in Indian investment was observed

following the formation of governments under the new constitution from 2018 (**Annexure-1**). This fluctuation indicates that, while political agreements and stability initially stimulated investment, subsequent political or economic uncertainties may have hindered sustained investment flows.

Furthermore, the sustained increase in Chinese investment from 2008 onwards, which has eventually exceeded both Indian and American investments, reflects a shifting landscape in Nepal's foreign investment dynamics (**Annexure-2**). The contrast between the fluctuating Indian investments and the steady rise in Chinese investments necessitates a thorough examination of the underlying factors influencing investor behaviour.

A critical question arises regarding the volatility of Indian investments and the sharp decline observed from FY 2019/20, during which only 19 projects were approved compared to 53 in FY 2018/19. It reached a single-digit figure (total of 09) in the fiscal year 2020/2021, the slowest pace since 1981(**Annexure-1**). Although the number of approved projects improved slightly in subsequent financial years, overall performance has remained below expectations. Despite this, India's FDI stock was the largest in Nepal during the same period, likely due to substantial investments by state-owned companies in the hydro-energy and financial and insurance sectors, in contrast to the relatively lower investment from private sector companies.

This trend necessitates a comprehensive analysis of the economic, political, and bilateral factors that may have contributed to this decrease, underscoring the complexities inherent in investment flows within the region.

## **Analyzing Fluctuations in Indian Investments**

Indian private investments in Nepal have experienced significant fluctuations since 1998. The investment trend can be categorised into two major phases: 2002-2005 and the post-constitution period. While the period from 1998 to 2002 saw a steady increase in Indian investments, there was a notable decline beginning in 2003, followed by another downturn in the post-constitution period.

The volatility of Indian investments, particularly between 2002-2005 and 2019, reflects the broader political and economic dynamics at play in Nepal. Several key factors have contributed to this volatility, including labour strikes, policy reforms, political instability, and the influence of regional geopolitics.

### **Labour Instability**

Nepal's political transition from a party-less Panchayat system to multiparty democracy in 1990 facilitated the formation of unions and associations by various political parties and the registration of civil society organisations. The Trade Union Act, enacted in 1992, enabled the registration of trade unions starting in 1993. Consequently, trade and labour unions emerged in both state-owned enterprises and private organisations/companies. These unions began negotiating with industries over financial and working conditions, leading to strikes and protests, often orchestrated by political parties to raise funds. The frequent strikes, driven by unresolved union demands, adversely impacted industrial operations and output. Many

industries suffered financial losses and were either forced to shut down or relocate. Dev Raj Dahal characterised the period from 1993 to 1999 as a “conducive” phase for union activism, whereas the period from 2000 to 2002 was marked by intensified challenges.<sup>4</sup>

For instance, in 2004, a Nepali labour union with affiliations to Maoist rebels demanded that 35 firms across the country shut down their operations.<sup>5</sup> Similarly, in 2008, numerous factories in Nepal ceased operations over a nine-month period due to demands from trade unions linked to political parties. Observers noted that these unions, particularly those affiliated with the Maoists, were engaging in extortion and issuing threats to industrialists. The Young Communist League (YCL), a Maoist youth organisation, actively campaigned on industrial estates to intimidate factory owners. Shalik Ram Jamakatel, then president of the Maoist trade union, indicated that his union had been expanding and planned to acquire a building valued at thousands of dollars.<sup>6</sup>

### **Economic Reforms and Trade Policies**

The policy reforms related to industries and import duties had a severe impact on the investment environment in Nepal. During the Panchayat regime, the domestic market was fully protected to ensure smooth business operations for domestic industries. However, in the early 1990s, Nepal initiated a series of market-oriented economic reforms under the Structural Adjustment Programs (SAP). Major reforms included liberalisation of trade and industrial policies and rationalisation of the foreign exchange regime. Following trade liberalisation, tariff rates were reduced, restructured, and rationalised, with quantitative restrictions and import licensing eliminated.<sup>7</sup> This policy shift transitioned the Nepali domestic market from a protected environment to a suddenly competitive one, where Nepali industries struggled to compete against imported goods due to lowered import duties. Additionally, production costs increased due to higher labour costs driven by union demands. Consequently, 679 enterprises in Nepal collapsed during 2001-2002, negatively impacting investor confidence in the new political system.<sup>8</sup>

The SAP also introduced new taxes, which increased the cost of finished products and rendered Nepalese companies less competitive in both global and regional markets. Highlighting the operational difficulties in Nepal in 2002, a spokesperson from Hindustan Lever, in a media interview, noted that “a large part of the raw material inputs used in the manufacture of personal

<sup>4</sup> Dev Raj Dahal, “The Current Trade Union Situation in Nepal”, P.2. For further details, refer to <https://library.fes.de/pdf-files/iez/01962.pdf> (accessed on 23 September 2024)

<sup>5</sup> “Nepal union asks 35 firms to close” *The Telegraph*, Kolkata, 08 September 2004, <https://www.telegraphindia.com/world/nepal-union-asks-35-firms-to-close/cid/1583144> (accessed on 22 September 2024)

<sup>6</sup> Subina Shrestha “Nepal Maoists ‘threaten industry’” *ALJAZEERA*, 26 December 2008, <https://www.aljazeera.com/news/2008/12/26/nepal-maoists-threaten-industry> (accessed on 22 September 2024)

<sup>7</sup> “Trends of Nepal’s Import Duties: Implications with Future Trade Liberalization,” *Economic Review*, Special Studies Division, Research Department, Nepal Rastra Bank, Government of Nepal, p.155.

<sup>8</sup> Dev Raj Dahal, *op.cit.*, P.1. For further details, refer to <https://library.fes.de/pdf-files/iez/01962.pdf> (accessed on 23 September 2024)

products, soaps and detergents are sourced from India and subjected to local levies. While such inputs used in manufacture of finished products qualify for credits while no such credit was available when manufacture took place in Nepal increasing the cost of goods produced there.”<sup>9</sup>

Other operational difficulties faced by Indian companies during the post-economic reform period of the 1990s include:

1. A countervailing duty on a maximum retail price (MRP) basis was introduced in the 2001 budget, levied on a range of products exported from Nepal.
2. The Nepalese government imposed a new export tax and suspended duty drawbacks, which resulted in substantial financial blockages, placing significant operational pressure on companies.
3. Transport unions in Nepal charged approximately INR 3,000 per truck in 2002 for transporting goods from Hetauda, near Raxaul (India's border point), a distance of 75 km, thereby making the delivered cost of Nepal-produced goods uncompetitive.<sup>10</sup>
4. Frequent *bandhs* (shutdown) and highway blockades declared by Maoist groups disrupted material supplies to industries, adversely affecting normal production and sales.
5. Major Indian companies adopted a cautious approach as the Maoists targeted their factories. For instance, the 2004 Maoist bomb blast at the Hindustan Lever factory delayed operations as the company undertook phased repairs and resumed operations gradually.<sup>11</sup>

### Political Instability

The frequent changes in government and Prime Ministers in the post-1990 period adversely affected investors' confidence in the Nepali market. The leftist parties were particularly critical of the economic reforms introduced by the Nepali Congress (NC). They opposed the privatisation of state-owned enterprises and the deregulation of business activities, which contributed to a sense of instability and uncertainty among investors.<sup>12</sup>

The economic reforms implemented by the NC leaders were either reversed or modified to align with communist ideologies following the formation of a new government in November 1994 under the leadership of Man Mohan Adhikari from the Communist Party of Nepal-

<sup>9</sup> “HLL may close down its Nepal subsidiary” *The Times of India*, 31 October 2002, <https://timesofindia.indiatimes.com/business/india-business/hll-may-close-down-its-nepal-subsidiary/articleshowprint/26852548.cms?val=3728> (accessed on 22 September 2024)

<sup>10</sup> Ibid.

<sup>11</sup> “Indian companies in Nepal alert as business gets on track” *The Economics Times*, 18 September 2004, <https://economictimes.indiatimes.com/indian-companies-in-nepal-alert-as-business-gets-on-track/printarticle/854959.cms> (accessed on 22 September 2024)

<sup>12</sup> Prithvi Man Shrestha, “A left turn Congress is taking as the party attempts to counter communist forces” politics, *The Kathmandu Post*, 08 May 2022, <https://kathmandupost.com/politics/2022/05/08/a-left-turn-congress-is-taking-as-the-party-attempts-to-counter-communist-forces> (accessed on 22 September 2024)

Unified Marxist Leninist (CPN-UML). During this period, driven by communist principles, the trade and labour unions affiliated with the CPN-UML became increasingly assertive against industrialists and private investors. The CPN-UML government, supported by the monarchy—which viewed the Nepali Congress as a pro-India party responsible for the political transformations of 1990—targeted Indian companies as part of a broader effort to reinvigorate nationalism in Nepal.

Interestingly, while the monarchy-supported UML government reversed the privatisation of state-owned enterprises, it failed to protect private industries and Indian joint ventures from the monopolistic practices of trade unions. Concurrently, Indian companies and investors were taken aback by the “community populist agenda”<sup>13</sup> under Man Mohan Adhikari’s leadership and the political rhetoric of UML-affiliated organisations, which branded India as an imperialist power. A Nepali scholar remarked, “Communist leaders [of Nepal] are the ones who groomed anti-Indian sentiments in Nepal and they are the ones who deal with India from a personal to a professional range.”<sup>14</sup>

In 1996, Sharma and Bajracharya conducted a research research on the impact of economic liberalisation in Nepal from 1974/75 to 1994/95, revealing an increase in the number of industries following the implementation of more liberalised policies. However, this positive trend reversed after the mid-term election of 1994, and a deceleration was observed during the brief and unstable rule of the CPN-UML.<sup>15</sup>

Moreover, during his official visit to India in April 1995, Prime Minister Adhikari advocated for a comprehensive review of the 1950 Peace and Friendship Treaty, which Nepal perceived as facilitating a demographic shift in the Terai region. He also brought up the Kalapani dispute with India. The inability to resolve these issues promptly exacerbated anti-India sentiments in Nepal, adversely affecting bilateral relations. Given that the 1950 Treaty is central to India-Nepal relations, PM Adhikari’s call for its revision generated insecurity among Indian investors in Nepal. While such bilateral visits and the raising of contentious issues are routine diplomatic exercises and often normalise over time, Indian organisations and private investors on the ground endure the repercussions of heightened anti-India sentiments, including harassment, non-cooperation by bureaucrats, local protests, extortion by trade unions, and pressures from radical left parties.

Historically, some political forces in Nepal have navigated complex domestic challenges by appealing to nationalistic sentiments, occasionally positioning India as a point of contrast. This approach has been utilised to unite the public and address internal concerns under the broader

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<sup>13</sup> Nabraj Lama, “Why Nepalis Hate India and How That Can Change” Opinion, *myRepublica*, Kathmandu, 04 June 2022, <https://myrepublica.nagariknetwork.com/news/why-nepalis-hate-india-and-how-that-can-change/> (accessed on 22 September 2024)

<sup>14</sup> Ibid.

<sup>15</sup> B. K. M. Singh and B. Paykuryal, “Impact of Economic Liberalization in Nepal -A Case of Industrial Growth in the Operating Industries in Butwal”, *Nepal Journal of Multidisciplinary Research (NJMR)* Vol. 4, No. 2, June 2021, p.3.

objective of safeguarding national interests. The CPN-UML government, after its formation, similarly engaged with contemporary issues, drawing on established strategies to assert its position while emphasising national sovereignty.

### **Maoist Conflict and Political Targeting of Indian Investments**

As foreign investors and domestic industries were attempting to adapt to new political and economic policies, the onset of violent conflict between the State and the Maoists in the mid-1990s further undermined investor confidence. As the conflict prolonged and expanded into new regions, both the Maoists and the State required resources. The Maoists, in particular, relied on extortion to fund their operations and began targeting foreign companies and joint ventures, which were perceived as more resourceful and less protected by state security measures. Politically, targeting foreign companies, especially Indian firms, served both financial and political objectives by exploiting anti-India sentiments and building support among their cadres.

Just before the onset of the People's War against the state, the Maoists issued a 40-point demand to the government, with the first four demands targeting India, the sixth demand was indirectly aimed at Indian investors. The demand stated, "The domination of foreign capital in Nepali industries, business and finance should be stopped."<sup>16</sup>

The Maoists gained significant popularity in Nepal from 1996 to 2005 by targeting Indian companies and Indian-invested projects. By September 2004, the Maoists had targeted approximately 47 Indian companies. A media report from September 8, 2004, indicated that the Maoist trade union had issued an email listing 36 companies, including Indian joint ventures, threatening to shut them down from September 10 unless the government addressed their demands. Earlier, ITC Surya Nepal, one of the largest Indian companies, had been shut down indefinitely from August 17, 2004, following a Maoist threat.<sup>17</sup> By February 2006, over 11 Indian companies<sup>18</sup> had either suspended their operations, relocated to India, or reduced their activities in Nepal due to security concerns.

Interestingly, despite India's pivotal role in the peace process by facilitating the 12-point agreement between the Maoists and the seven political parties in New Delhi, the Maoists continued to target Indian companies. For example, the Arun-3 and GMR's Upper Karnali projects were threatened in December 2010. Similarly, Dabur India, which was established in 1989 and had an annual turnover of INR 300 crore as of 2006, closed its production unit in Birgunj in April 2006 due to pressure from Maoist unions.

In the 2008 elections, the Maoists emerged as the largest party in the Constituent Assembly, which also served as the parliament. Despite their status as a mainstream party, the Maoists

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<sup>16</sup> 40 Point Demand, 04 February, 1996, Central Committee, United People's Front, Nepal.

<sup>17</sup> "Maoists target Tata Motors' dealer in Kathmandu" *Hindustan Times*, New Delhi, 08 September 2004, <https://www.hindustantimes.com/india/maoists-target-tata-motors-dealer-in-kathmandu/story-QtitlXyOXbPo48kx7b8LML.html> (accessed on 22 September 2024)

<sup>18</sup> ITC Surya Nepal, Unilever Nepal, Colgate-Palmolive, Reliance Mills, Goodricke Tea, Dabur Nepal, Asian Paints, United Telecom Limited, Sripadi Trading Pvt Limited, Coca-Cola India, Manipal Hospital (Pokhara) and Dabur.

intensified their targeting of Indian companies in the post-conflict period. This escalation was driven by the need to secure funds for party operations within a democratic framework with limited financial resources. Consequently, they continued to target Indian companies for quick financial gains. Additionally, many domestically invested companies had gone bankrupt due to the prolonged conflict, leading the Maoists to view Indian companies as both vulnerable and possessing substantial cash reserves.<sup>19</sup>

### Absence of Bilateral Investment Protection

The absence of a bilateral investment protection treaty (BIPPA) between India and Nepal until 2011 significantly contributed to the volatility in Indian investments. The lack of formal investment protection measures heightened concerns among Indian investors, leading to a substantial reduction in new investments in Nepal.<sup>20</sup> However, the situation began to improve following the signing of the BIPPA and the Double Taxation Avoidance Agreement (DTAA) between the two countries in 2011.

### Post-Constitution Investment Scenario

Nepal's adoption of a new constitution in 2015 marked a turning point, with hopes of attracting more investments under the new political framework. The government introduced several administrative, institutional, and policy reforms aimed at signaling improved security and a favorable investment climate. These efforts were intended to reassure international investors, particularly from India, that Nepal had become a more stable and secure market.

**Table 2: Investment pledges of India and China in Nepal since 2017**

(1US\$=133.74 NPR)

Investment summit	India	China	Total pledges
First-2017	\$317 million	\$8.3 billion	NPR 1400 billion (\$13.52 billion)
Second-2019	NPR 65.3 billion \$488.26 million	NPR 32 billion \$239.27 million	NPR 163.04 billion (\$1.22 billion)
Third-2024* <sup>21</sup>	--	--	NPR 9 billion <sup>22</sup> \$67.29 million

Source: *IBN Dispatch-2017*. \*Project approval process changed.

In this regard, as **Table-2** indicates, the government organised its first investment summit in March 2017, which attracted \$13.5 billion in investment commitments from six countries. The

<sup>19</sup>“Maoists milk Indian firms in Nepal” *Hindustan Times*, New Delhi, 15 August 2007, <https://www.hindustantimes.com/world/maoists-milk-indian-firms-in-nepal/story-2K1mG3HVp4uB50eXTyBK9K.html> (accessed on 22 September 2024)

<sup>20</sup> Pankaj Vashisht, “Analyzing India-Nepal Economic Integration: Status, Challenges and Way Forward” RIS Discussion Paper Series, Discussion Paper # 290, February 2024, p.23.

<sup>21</sup> The summit witnessed the inking of about 12 MoUs between Nepal and its development partners and foreign investors.

<sup>22</sup> “Nepal Investment Summit concludes; funding worth NRs 9 billion approved” *Business Standard*, 29 April 2024, [https://www.business-standard.com/world-news/nepal-investment-summit-concludes-funding-worth-nrs-9-billion-approved-124042901233\\_1.html](https://www.business-standard.com/world-news/nepal-investment-summit-concludes-funding-worth-nrs-9-billion-approved-124042901233_1.html) (accessed on 22 September 2024)

second edition, held in 2019, garnered \$12 billion in commitments, marking a decline from the previous summit.<sup>23</sup> Nepal did not host any further investment summits until 2023 due to COVID-19 restrictions and frequent political changes in Kathmandu.

The third edition of the summit was organised in April 2024, attracting over 1,100 foreign participants, primarily from India and China. Interestingly, while China asserted that it was the top source of FDI for Nepal, India claimed to hold the largest FDI stock, amounting to 33 per cent of total FDI in Nepal, which is approximately NPR 89 billion.

The year-wise and investment summit-wise analysis of India's investment flow to Nepal in the post-constitution period witnessed a stagnant trend, reflecting a lack of confidence and interest from Indian investors in the Nepalese market. According to a study, "the share of India in total FDI stock of Nepal decline to below 20 per cent in 2016"<sup>24</sup> attributed to the unfavorable business environment in Nepal. This decline may also indicate a deficiency in coordination and trust between Indian policymakers and private investors.

### Stagnant Private Investments

Despite an overall upward trend in Indian investments in the post-constitution period, with some early setbacks, the total volume of investments has still not returned to the levels observed before the conflict in 1990. Importantly, there is a notable discrepancy between investments from private sources and those from state-owned enterprises (SOEs). The increase in Indian investments in Nepal post-constitution has been predominantly driven by SOEs, particularly in large hydro projects.

**Table 3: Cumulative FDI Stock of India and China in Nepal**

(NPR in millions)

Financial Year	India		China	
	FDI Stock	Share in Total %	FDI Stock	Share in Total %
2016/2017	32,868.4	19.5	17,128.0	10.2
2017/2018	41,737.3	20.18	26812.8	13.37
2018/2019	56,054.6	30.6	27,560.2	15.1
2019/2020	62,447.2	31.5	30,971.5	15.6
2020/2021	75,814.2	33.3	33,001.0	14.5
2021/2022	88,592.6	33.5	33,448.6	12.7
2022/2023*	103,452.3	35.0	35,461.5	12.0

Source: *Survey Report on FDI in Nepal (2016-2023)*, Nepal Rastra Bank, Nepal. \*Till mid-July of every year.

<sup>23</sup> Shivam Shekhawat, "Vying for investments: Nepal's quest to become a 'zone of investment'" Observer Research Foundation, 27 May 2024, <https://www.orfonline.org/expert-speak/vying-for-investments-nepal-s-quest-to-become-a-zone-of-investment#:~:text=The%20Government%20of%20Nepal%20organised,in%202017%20made%20by%20China> (accessed on 22 September 2024)

<sup>24</sup> Pankaj Vashisht, *op.cit.*, p.23.

The **Table -3** reflects that although India remained the top investors in terms over all FDI stuck in Nepal, at the same time, investments from the private sector have yet to return to pre-conflict levels. While the manufacturing, accommodation, and food services sectors in Nepal receive the bulk of investments from Indian private companies, state-owned enterprises dominate the hydroelectricity, financial, and insurance sectors. For instance, in July 2024, IREDA announced a ₹ 290 crore investment for a 10 per cent stake in the 900 MW Upper Karnali Hydro-Electric Power Project. Similarly, in August 2022, the Investment Board Nepal approved India's state-owned NHPC Limited to study and develop two hydropower projects totaling 1,200 MW in western Nepal. These projects include the 750 MW West Seti Hydropower Project and the 450 MW Seti River (SR-6) joint storage project, with an estimated cost of \$2.4 billion.<sup>25</sup>

State-owned enterprises (SOEs) have shown increasing willingness to develop large-scale hydroelectric projects in Nepal, a sentiment supported by both countries' agreements to jointly develop such projects. In February 2022, the two countries decided to form a joint technical team for this purpose during the 9th Joint Steering Committee meeting at the secretary level held in Kathmandu. This decision was followed by a joint vision statement on power sector cooperation unveiled during the Nepal Prime Minister's visit to India in April 2022.<sup>26</sup>

On the other hand, private sector companies have yet to overcome the challenges from the pre-constitution period. Despite the adoption of a new constitution and a strong presence of Indian companies at the three investment summits and the 2023-power summit, the private sector remained hesitant to invest in Nepal due to the following factors:

**Political Instability:** Frequent changes in government and political uncertainty may have led to a lack of confidence among Indian investors. Despite the initial optimism from the peace process, ongoing political turbulence has likely created an unpredictable investment environment.<sup>27</sup> Concerns persist over the potential relapse of civil conflict or Maoist insurgency, exacerbated by poor governance, high levels of corruption, growing anti-India sentiments due to unresolved bilateral disputes, a left-leaning bureaucracy favoring Chinese

<sup>25</sup> "Nepal gives nod to India's NHPC to build two projects totalling 1,200MW" *Investment Board Nepal*, Government of Nepal, 10 August 2022, <https://ibn.gov.np/ibn-notice/details/nepal-gives-nod-to-india%E2%80%99s-nhpc-to-build-two-projects-totalling-1200mw-5586> (accessed on 22 September 2024)

<sup>26</sup> "India's private players see big opportunities in Nepal's power sector with eye on region" *Energy World* (The Economics Times), New Delhi, 19 April 2023, <https://energy.economictimes.indiatimes.com/news/power/indias-private-players-see-big-opportunities-in-nepals-power-sector-with-eye-on-region/99599474#:~:text=8%20min%20read-India's%20private%20players%20see%20big%20opportunities%20in%20Nepal's%20power%20sector,partnership%20in%20the%20energy%20sector> (accessed on 22 September 2024)

<sup>27</sup> "The Dismal Reality of Business Investment" Feature, *Business360*, Kathmandu, 09 January 2024, <https://www.b360nepal.com/detail/21589/the-dismal-reality-of-business-investment-2023-Dec-31-234300> (accessed on 22 September 2024)

over Indian projects, tensions between Pahadis and the Teraians, and the influence of extra-regional powers on domestic policies.

**Shifts in Investment Policies:** Changes in regulations or policies governing foreign investments with the change in government in Kathmandu could have affected Nepal's attractiveness as an investment destination. Restrictive measures or bureaucratic hurdles might have discouraged Indian companies from pursuing new projects.

For example, in a media interview in June 2024, Indian investors highlighted several challenges they face while doing business in Nepal, including:

- a) Foreign investors have faced challenges in remitting funds from Nepal due to the complexity of the process.
- b) Multi-level approval processes for repatriation of profits or convertibility of foreign currency, making the process long and cumbersome. CEO and MD, Ncell, Jabbor Kayumov, observed that “repatriation of dividends is somehow treated and perceived negatively”<sup>28</sup> in Nepal.
- c) Difficulties in making payments to foreign suppliers.
- d) Effects of the post-COVID-19 economic slowdown on the construction and manufacturing sectors..
- e) Increased manufacturing costs in Nepal due to discrepancies in customs duties on raw materials versus finished products, creating an uneven playing field.
- f) Concerns regarding the retention of earnings by Indian nationals working in these companies and high tax rates in Nepal, which are among the highest globally.<sup>29</sup>
- g) Varied responses to policy changes across different sectors. For example, in the telecom sector, regulatory hurdles and outdated policies have been particularly challenging. The sector is highly regulated with laws and regulations that are nearly 30 years old and no longer relevant.<sup>30</sup>
- h) Despite major reforms such as the Foreign Investment and Technology Transfer Act, Electronic Transaction Act, Public Private Partnership and Investment Act, Industrial

<sup>28</sup> “How favourable is the investment ecosystem?” Opinion, *Business360*, Kathmandu, 29 April 2024, <https://www.b360nepal.com/detail/22321/how-favourable-is-the-investment-ecosystem-2024-Apr-29-499800> (accessed on 27 September 2024)

<sup>29</sup> “DPM Shrestha, Indian multinational companies' reps discuss investment challenges, opportunities” National, *Business360*, Kathmandu, 13 June 2024, [DPM Shrestha, Indian multinational companies' reps discuss investment challenges, opportunities - B360 :: Business 360° \(b360nepal.com\)](https://www.b360nepal.com/detail/22321/how-favourable-is-the-investment-ecosystem-2024-Apr-29-499800) (accessed on 22 September 2024)

<sup>30</sup> “How favourable is the investment ecosystem?” *op.cit.*, no. 28.

Enterprise Act, and Forest Act, new entrants or projects from India still face slow approval processes.

***India and Nepal Bilateral Issues:*** Periodic strains in diplomatic relations between the two countries might have influenced investment flows. Political tensions or unresolved issues could have created apprehensions among Indian investors about the stability and reliability of their investments.

***Comparison with Investment Climate in India:*** Opportunities and the business environment in India have been more favorable since the country adopted economic reforms in 1991. Factors such as higher input costs in Nepal—including labour, taxes on raw materials, smaller market size, high internal transportation costs, expensive electricity, and the presence of labour unions under leftist parties—make it less attractive for Indian manufacturing companies. Additionally, the availability of cheaper Indian goods in the Nepali market, often imported illegally through open borders, further discourages investment. Amlan Mukherjee noted that “the duties imposed upon certain categories of raw materials remain on par or higher when compared with the finished goods imported. This inverted duty structure remains a major challenge in accelerating the process of manufacturing more products locally.”<sup>31</sup>

## Recommendations and Conclusion

These recommendations are formulated by taking into account ground realities, a thorough analysis of historical facts, and insights provided by prominent Indian business leaders during interviews with the *Business 360*<sup>32</sup>.

1. **Enhance Foreign Exchange Regulations and Reforms:** Since FDI is typically made in foreign currency, investors need mechanisms to repatriate profits, such as swaps, hedges, and other financial products. To improve the environment for FDI in Nepal, it is crucial to focus on regulations and reforms related to foreign exchange. The speed of implementing these tools could significantly impact investor confidence.
2. **Streamline Processes:** The investment process should be simplified to provide greater clarity and efficiency. It must become less time-consuming and burdensome, with a well-defined authority matrix at the single-window service center to ensure a smooth and expedited process. Additionally, efforts should focus on strengthening bilateral trade and investment agreements, tackling corruption and bureaucratic inefficiencies, and fostering stronger public-private partnerships.

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<sup>31</sup> Ibid.

<sup>32</sup> Ibid.

3. **Simplify Regulations on Remittances:** Implementing simplified, effective, and practical regulations for the remittance of dividends, royalties, service charges, and earnings of expatriates would further attract investment to Nepal.
4. **Ensure Policy Consistency:** Consistency in policy is essential for investors making long-term strategic decisions. Frequent changes in policies can deter investment. Regardless of government changes, the message should be that policies towards FDI will remain stable and investor-friendly. Effective execution and implementation of legislative reforms are crucial for maintaining investor trust.
5. **Upgrade Infrastructure:** Continuous improvement in physical infrastructure (roads, energy, dry ports, customs, warehousing) and digital infrastructure is essential. Nepal should also focus on providing a skilled workforce and reliable local vendors and suppliers to meet sourcing needs.
6. **Strengthening IPR Laws:** Nepal's intellectual property rights (IPR) laws are weak and lack robust enforcement mechanisms, which poses a significant barrier to attracting foreign investments. Strengthening these laws is essential for creating a secure environment where businesses and innovators feel confident that their ideas, products, and brands will be protected.
7. **Gap in FDI commitments and actual realization:** There is a significant gap between FDI commitments and their actual realization, as shown by Nepal Rastra Bank and Department of Industry reports. The government should establish a dedicated follow-up desk to monitor FDI pledges regularly.

Indian investments, while still play a key role in Nepal's development, face several challenges that need to be addressed to increase the investment flows. Apart from domestic issues, strengthening India-Nepal relations will be key to ensuring that Nepal meets its development goals by 2030.

## Annexure-1

### Industries Approved for Foreign Investment-India (Rs in Million)

Year	No of Industries	Total Project cost	Fixed Capital	Working Capital	Foreign Investment	Employment (in number)
2004/05	9	578.88	344.86		223.76	2849
2005/06	25	1736.77	1314.09		803.99	2039
2006/07	22	1761.04	1421.1		1719.54	1602
2007/08	29	5179.84	3915.7		3645.4	2569
2008/09	28	3887.24	2782.01		2341.31	1756
2009/10	27	7789.53	7372.05		3993.54	1835
2010/11	38	7876.51	6555.85		7007.26	3274
2011/12	24	3887.82	3485.03		2298	1754
2012/13	41	9187.11	7416.41	1770.7	2809.07	3471
2013/14	22	8,378.69	7,785.84	592.85	6,540.83	2,108
2014/15	25	43,416.19	42,356.09	1,060.10	34,719.00	712
2015/16	23	2,339.70	954.2	1,385.50	1,941.91	764
2016/17	41	2,434.40	1,770.45	663.95	2,082.89	1,622
2017/18	53	5,401.32	3,992.10	1,409.22	5,098.81	2,719
2018/19	53	5,401.32	3,992.10	1,409.22	5,098.81	2,719
2019/20	19	10,867.47	6,780.96	4,086.51	3,897.09	561
2020/21	9	1,120.00	620.2	499.8	726	380
2021/22	12	3,143.83	2,796.81	347.02	2,485.40	663
2022/23	11	2,085.82	1,952.68	133	604.94	510

**Source:** Industrial Statics, Department of Statistics, Ministry of Industry, Governmental Nepal. Nepal India Chamber of Commerce and Industry. \* the data for 2017-2019 in the table is taken as mentioned in the original report.

## Annexure-2

### China, India and US Investments in Nepal (2004/05-2022/23)

(Rs in million)

Year	Country	No. of Industries	Total Project Cost	Total Fixed Cost/Fixed Capital	Working Capital	Foreign Investment	Total No of Employment
2004/05	China	7	213.43	144.86		142.31	257
	India	9	578.88	344.86		223.76	2849
	USA	1	116	80		50	650
2005/06	China	16	331.04	173.3		149.44	694
	India	25	1736.77	1314.09		803.99	2039
	USA	5	430	402.5		406	410
2006/07	China	25	217.95	166.53		263.13	1135
	India	22	1761.04	1421.1		1719.54	1602
	USA	12	60.1	47.98		60.1	429
2007/08	China	15	248.8	183.75		231.3	731
	India	29	5179.84	3915.7		3645.4	2569
	USA	9	85.23	74.24		81.98	308
2008/09	China	51	887.77	726.11		875.24	4111
	India	28	3887.24	2782.01		2341.31	1756
	USA	8	50.5	37.4		44	221
2009/10	China	58	731.25	558.62		715.75	2791
	India	27	7789.53	7372.05		3993.54	1835
	USA	10	52.3	40.05		51.3	307
2010/11	China	69	1220	930.92		1187.4	3066
	India	38	7876.51	6555.85		7007.26	3274
	USA	8	94.3	79.03		81.4	253
2011/12	China	77	1009.53	814.62		986.03	3326
	India	24	3887.82	3485.03		2298	1754
	USA	24	227.4	188.22		182.16	589
2012/13	China	97	5956.6	5406.02	550.58	2771.8	4943
	India	41	9187.11	7416.41	1770.7	2809.07	3471
	USA	24	651.3	578.5	72.8	380.5	853
2013/14	China	119	23,272	21,712.55	1,559.45	7,314.44	4,618
	India	22	8,378.69	7,785.84	592.85	6,540.83	2,108
	USA	28	594.37	522.1	72.27	536.21	850
2014/15	China	154	4,868.66	4,049.70	818.95	4,373.25	5,908
	India	25	43,416.19	42,356.09	1,060.10	34,719.00	712

	USA	33	748.61	613.36	135.25	597.48	819
2015/16	China	125	6,788.54	3,774.72	3,013.82	6,211.81	5,527
	India	23	2,339.70	954.2	1,385.50	1,941.91	764
	USA	40	2,358.32	2,002.32	356	701.02	916
2016/17	China	183	6,743.51	5,585.74	1,157.77	6,246.75	5,487
	India	41	2,434.40	1,770.45	663.95	2,082.89	1,622
	USA	39	399.24	315.34	83.9	352.76	979
2017/18	China	160	49,027.00	47,198.03	1,828.97	46,506.94	6,369
	India	53	5,401.32	3,992.10	1,409.22	5,098.81	2,719
	USA	35	2,977.62	2,607.60	370.02	1,088.62	897
2018/19*	China	160	49,027	47,198.03	1,828.97	46,506.94	6,369
	India	53	5,401.32	3,992.10	1,409.22	5,098.81	2,719
	USA	35	2,977.62	2,607.60	370.02	1,088.62	897
2019/20	China	176	25,900.70	19,914.24	5,986.46	25,582.65	8,946
	India	19	10,867.47	6,780.96	4,086.51	3,897.09	561
	USA	4	4,583.97	4,534.31	49.66	4,228.94	268
2020/21	China	140	22,345.00	13,897.12	8,447.88	22,502.20	4,506
	India	9	1,120.00	620.2	499.8	726	380
	USA	7	1,880.00	1,315.88	564.12	1,678.94	140
2021/22	China	230	42,774.00	30,231.97	12,542.04	42,724.05	13,601
	India	12	3,143.83	2,796.81	347.02	2,485.40	663
	USA	14	3,798.98	572.53	3,226.45	650	729
2022/23	China	174	15,004.00	12,867.00	2,136.69	14,481.00	9095
	India	11	2,085.82	1,952.68	133	604.94	510
	USA	19	530	430.83	99	530	598

**Source:** *Industrial Statics, Department of Statistics, Ministry of Industry, Governmental Nepal. Nepal India Chamber of Commerce and Industry.* \* the data for 2017-2019 in the table is taken as mentioned in the original report.

## Annexure-3

### Nepal's Investment Policies and Major Indian Investments (1981-2002)

Year	Policy	Indian Companies
1981	New Industrial Policy and the Foreign Investment and Technology Act	
1982	Industrial Enterprises Act	
1985		Asian Paints
1986		ITC-Surya Nepal
1987	Revised Industrial Policy	
1989		Dabur
1991	India-Nepal Trade Treaty	
1992	Foreign Investment and Technology Transfer Act (FITTA)	Nepal SBI Bank Ltd
1994		Manipal Group
1997		PNB-Everest Bank JV
1998		Colgate Palmolive
2000		LIC Nepal Limited
2002	Series of Financial Sector Reforms	

**Source:** *English media published from India and Nepal.*

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