



Foreign Direct Investment in Nepal: A Comprehensive Analysis of Trends, Challenges, and Strategic Pathways

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Abstract

Background: Nepal relies Foreign Direct Investment (FDI) for economic transformation, however, faces a critical challenge in converting approved commitments into actual inflows. Despite progressive policy reforms including the One Stop Service Centre and Automatic Route approval, systematic implementation barriers persist.

Methods: This study employs qualitative research examining the secondary data analysis of FDI trends from 2069/69 to 2080/92. Data sources include the Department of Industry Annual, Investment Board Nepal, Nepal Rastra Bank and other empirical researches. Analytical techniques include commitment inflow ratio analysis, sectoral decomposition and comparative regional assessment.

Result: Analysis reveals only 38.9% of approved FDI commitments materialize as actual inflows, representing a 61% realization gap; sectoral composition shifted dramatically from energy dominance (80% in 2071/72) to service and tourism (83% in 2080/81). Geographic concentration remains high with China and India accounting for 66.88% of cumulative and human capital constraints constitutes primary implementations barriers.

Conclusion: Although Nepal's FDI environment faces low investment realization rates, infrastructure deficits and institutional limitations, considerable opportunities remain. Closing the commitment realization gap requires better infrastructure, streamlined approvals, targeted



incentives and greater geographic diversification. With sustained implementation, Nepal holds strong potential to attract foreign investment and become a regionally competitive destination.

Novelty: This research provides a comprehensive empirical assessment of Nepal's FDI landscape through 2081/82, quantifying the commitment realization gap and offering evidence-based policy interventions grounded in current data rather than historical analysis.

Keywords: Commitment-Realization Gap, Economic Development, Foreign Direct Investment, Policy Implementation, Sectoral Analysis

1. Introduction

Foreign Direct Investment (FDI) constitutes a critical driver of economic development, extending beyond the mere transfer of financial capital to encompass the diffusion of technology, managerial expertise, integration into global markets, and employment generation (Dunning & Lundan, 2008). For landlocked developing economies such as Nepal, characterized by constrained domestic capital formation, limited fiscal capacity, and persistent infrastructural deficits, FDI represents a crucial mechanism for facilitating sustainable economic growth and structural transformation (UNCTAD, 2023). Nepal continues to face enduring macroeconomic vulnerabilities, including chronic trade deficits averaging approximately 32% of Gross Domestic Product (GDP), a high dependence on remittance inflows contributing around 24% of GDP, and a narrow export base, with merchandise exports accounting for only 8.2% of GDP (World Bank, 2023). Although FDI inflows have exhibited a modest upward trajectory in recent years, Nepal remains significantly behind regional comparators, with FDI contributing only 0.03% to GDP (Parul, 2021). Furthermore, Nepal's SDG Financing Strategy (2034–2030) estimates an average annual financing gap of approximately NPR 755 billion to achieve the Sustainable Development Goals (SDGs), exceeding the earlier estimate of NPR 585 billion reported by the United Nations Development Program (UNDP) (2021). At the same time, multidimensional poverty remains a substantial challenge: according to the Global Multidimensional Poverty Index (MPI) 2025 published by the UNDP and the Oxford Poverty & Human Development Initiative (OPHI), 20.1% of Nepal's population was multi dimensionally poor in 2022, compared to 17.4% based on 2019 estimates. In recognition of these structural constraints, the Government of Nepal has positioned FDI as a central pillar of its national development strategy, as articulated in the Sixteenth Five-Year Plan (2024/25–2028/29) and the long-term national vision of achieving 'Prosperous Nepal, Happy Nepali' by 2030 (National Planning Commission, 2020).

In this backdrop, this study advances three interrelated objectives. First, it undertakes a systematic empirical analysis of FDI trends, sectoral composition, and geographic distribution in Nepal from fiscal year 2069/70 to 2080/81, drawing on official data from the Department of Industry (DoI). Second, it examines the persistent gap between approved FDI commitments and actual investment realization, with particular attention to the structural, institutional, and policy-related factors underpinning this discrepancy. Third, it formulates evidence-based policy recommendations aimed at enhancing Nepal's capacity to attract, retain, and effectively



utilize FDI for long-term developmental outcomes. Aligned with these objectives, this study investigates three interrelated research questions: (i) What are the major trends and patterns of foreign direct investment in Nepal over the past decade? (ii) What factors explain the substantial divergence between approved FDI commitments and realized investments? (iii) What policy and institutional reforms are required to strengthen Nepal's investment climate and maximize the developmental benefits of FDI? By addressing these questions, the study contributes to both scholarly debates and policy discourse by providing empirically grounded insights and context-specific recommendations, thereby helping to bridge a critical knowledge and policy gap in Nepal's pursuit of its 2030 development objectives.

2. Literature Review

FDI has long been recognized as a central component of economic development, particularly in developing economies seeking to accelerate structural transformation and global integration. Dunning's (1980) eclectic paradigm provides a foundational framework for understanding FDI flows, emphasizing the interaction of ownership, location, and internalization advantages in shaping investor decisions. Within this framework, location-specific advantages such as natural resource endowments, market size, labor costs, infrastructure, and institutional quality are especially critical in determining the attractiveness of host countries (Blonigen & Piger, 2014). FDI contributes to economic development through multiple transmission mechanisms. These include technology spillovers via labor mobility, demonstration effects, and backward and forward linkages with domestic firms (Görg & Greenaway, 2004), as well as employment generation and integration into global value chains. Moreover, multinational enterprises enhance export competitiveness by transferring quality standards, managerial practices, and access to international markets (Helpman et al., 2004). However, the realization of these developmental benefits is conditional upon host-country absorptive capacity, including human capital development, institutional effectiveness, and domestic entrepreneurial capabilities (Borensztein et al., 1998). These theoretical insights are directly relevant to Nepal, where understanding sectoral patterns and institutional constraints is essential to explain both FDI trends and the gap between investment commitments and actual realization.

Within South Asia, FDI performance varies considerably, reflecting differences in policy regimes, institutional environments, and structural conditions. India dominates the region, attracting USD 49.3 billion in FDI in 2022, while smaller economies such as Nepal, Bhutan, and Afghanistan continue to receive significantly lower inflows (UNCTAD, 2023). Bangladesh provides an important example of successful FDI-led industrialization, particularly in its garment sector, where preferential market access, competitive labor costs, and policy reforms have enabled annual inflows of approximately USD 3.5 billion (Rahman & Sayeda, 2016). Sri Lanka has attracted substantial FDI into tourism and port infrastructure despite periods of political instability (Athukorala, 2003). Nepal's FDI trajectory differs from these export-oriented or resource-focused models. Instead of concentrating investment in a few strategic sectors, Nepal has pursued a relatively diversified approach across tourism, services, manufacturing, and renewable energy (Dhungel, 2011). However, persistent infrastructure



deficits, political uncertainty, and institutional weaknesses have constrained Nepal's competitiveness relative to its regional peers (Khanal & Khanal, 2010). These regional comparisons highlight the importance of examining Nepal's sectoral distribution and structural constraints, which form a key focus of this study's analysis of FDI patterns and performance. The challenges faced by Nepal are further compounded by its status as a landlocked developing country (Pandey et al., 2018). Geographic isolation increases transportation costs, creates dependence on transit countries, and limits integration into global markets, thereby reducing investment attractiveness (Faye et al., 2004). Empirical evidence suggests that landlocked countries receive approximately 30% less FDI than comparable coastal economies (Vijil & Wagner, 2012). Nonetheless, international experience demonstrates that these geographic disadvantages can be mitigated through sound macroeconomic policies, strong institutional frameworks, and effective regional integration, as illustrated by countries such as Botswana, Rwanda, and Mongolia (Collier, 2007). In the context of Nepal, previous studies identify infrastructure development (Bhattarai, 2011), political stability (Sharma & Khanal, 2022), regulatory quality (Adhikari & Shrestha, 2023), and human capital (Poudel & Khanal, 2016) as critical determinants of FDI inflows. However, much of this literature predates recent institutional and procedural reforms, including the establishment of the One Stop Service Centre (OSSC) and the introduction of the Automatic Route mechanism. As a result, there remains a significant empirical gap in understanding how these reforms have influenced recent FDI trends, investment realization, and investor behavior.

Recognizing the importance of institutional frameworks, Nepal has progressively liberalized its FDI policies over the past three decades. Prior to 1992, foreign investment was heavily restricted, with strict government controls limiting inflows to fewer than NPR 500 million annually, primarily through joint ventures with Nepali majority ownership (Acharya, 1998). The enactment of the Foreign Investment and Technology Transfer Act (FITTA) 1992 marked a significant shift toward liberalization by allowing full foreign ownership in most sectors and guaranteeing profit repatriation, although bureaucratic inefficiencies and political instability continued to hinder investor confidence (Bajracharya, 2010). The most recent phase of reform, initiated with FITTA 2019 and reinforced by the Industrial Enterprises Act 2020, introduced provisions aligned with international investment standards, including equal treatment of foreign and domestic investors, protection against nationalization, simplified technology transfer, tax incentives, and access to international arbitration mechanisms. These reforms reflect Nepal's strategic effort to improve its investment climate and address institutional bottlenecks affecting investment realization.

Furthermore, Nepal has introduced procedural innovations aimed at improving investment facilitation and reducing administrative barriers. The Automatic Route, introduced in April 2024, represents a major step toward simplifying approval procedures. Within its first three months, 90 projects worth NPR 5,648 million were approved, accounting for 20% of total approvals by number but only 11.3% by value, indicating its predominant use by small and medium scale investors (Department of Industry, 2024). The concentration of approvals in tourism, services, and ICT sectors suggests that procedural simplification may be particularly



effective in promoting investment in less capital-intensive sectors, while large-scale infrastructure and energy projects continue to face complex regulatory scrutiny. These trends highlight the importance of examining sectoral and size-based variations in FDI patterns, which is a central objective of this study.

Institutional facilitation mechanisms have also been strengthened through the establishment of the OSSC in 2019. By integrating services from 14 government agencies, the OSSC has reduced administrative processing times, handling 6,219 FDI approvals through 2080/81 and significantly shortening company registration and tax processing periods (Department of Industry, 2024). However, despite these improvements, investors continue to face post-approval challenges related to environmental clearances, land acquisition, and local-level permits, which remain outside the OSSC's jurisdiction. These persistent institutional fragmentation issues provide important insights into the structural causes of Nepal's commitment-realization gap. Similarly, the Investment Board Nepal (IBN), established to facilitate large-scale strategic investments, plays a critical role in attracting mega-project FDI, particularly in hydropower and infrastructure sectors. Although the IBN has approved 24 projects worth approximately NPR 480 billion, implementation rates remain relatively low (IBN, 2023). This discrepancy between approved investments and actual implementation reflects broader structural and institutional challenges within Nepal's investment governance system. Understanding these implementation constraints is essential for explaining the persistent gap between FDI commitments and realization, which constitutes one of the central research questions of this study.

The existing literature highlights the importance of institutional quality, policy frameworks, and structural conditions in shaping FDI inflows and outcomes. However, there remains limited empirical research examining Nepal's recent FDI trends, sectoral distribution, and institutional reforms in an integrated manner. In particular, insufficient attention has been given to the commitment-realization gap and the effectiveness of recent policy innovations such as the Automatic Route and the OSSC. By addressing these gaps, this study contributes to the literature by providing a comprehensive and updated empirical analysis of Nepal's FDI patterns, institutional performance, and policy implications, thereby supporting evidence-based reforms to enhance Nepal's investment environment.

3. Research Methods

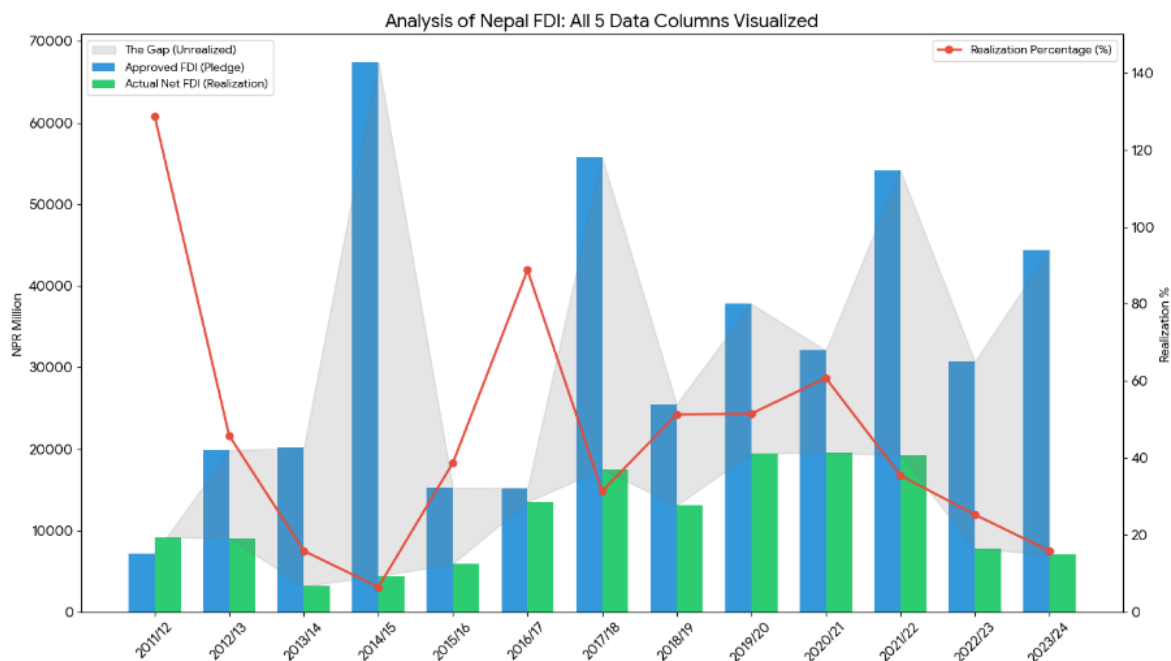
This study adopts a mixed-method explanatory research design, combining quantitative analysis of Foreign Direct Investment (FDI) data with qualitative institutional and policy analysis. This approach is appropriate because the research seeks not only to examine empirical trends and patterns of FDI in Nepal, but also to explain the institutional, structural, and policy factors underlying the gap between approved commitments and actual investment realization, and to develop evidence-based policy recommendations. Mixed-method designs are widely used in investment and development studies to integrate statistical trend analysis with institutional interpretation, thereby providing a more comprehensive understanding of investment dynamics in developing economies. The study is structured around three

interrelated analytical components aligned with the research objectives: Quantitative trend and pattern analysis of FDI approvals and realization; Institutional and gap analysis of commitment versus realization; Policy and governance analysis of investment facilitation mechanisms. These components correspond directly to the three research questions concerning FDI trends, realization gaps, and policy reforms. The study relies primarily on secondary data obtained from official government and institutional sources, supplemented by policy documents and institutional reports. The study employed descriptive statistical analysis methods for data analysis. The study used publicly available secondary data and policy documents and no human participants were involved therefore there is no ethical risk present.

4. Empirical Analysis of FDI Trends and Patterns

The analysis of commitment and inflow paradox shows the persistent gap between approved commitments and actual inflows of Nepal's FDI landscape. Figure 1 presents comparative data for the period 2011/12-2023/24.

Figure 1. Foreign Direct Investment inflows Nepal (IBN, 2024)

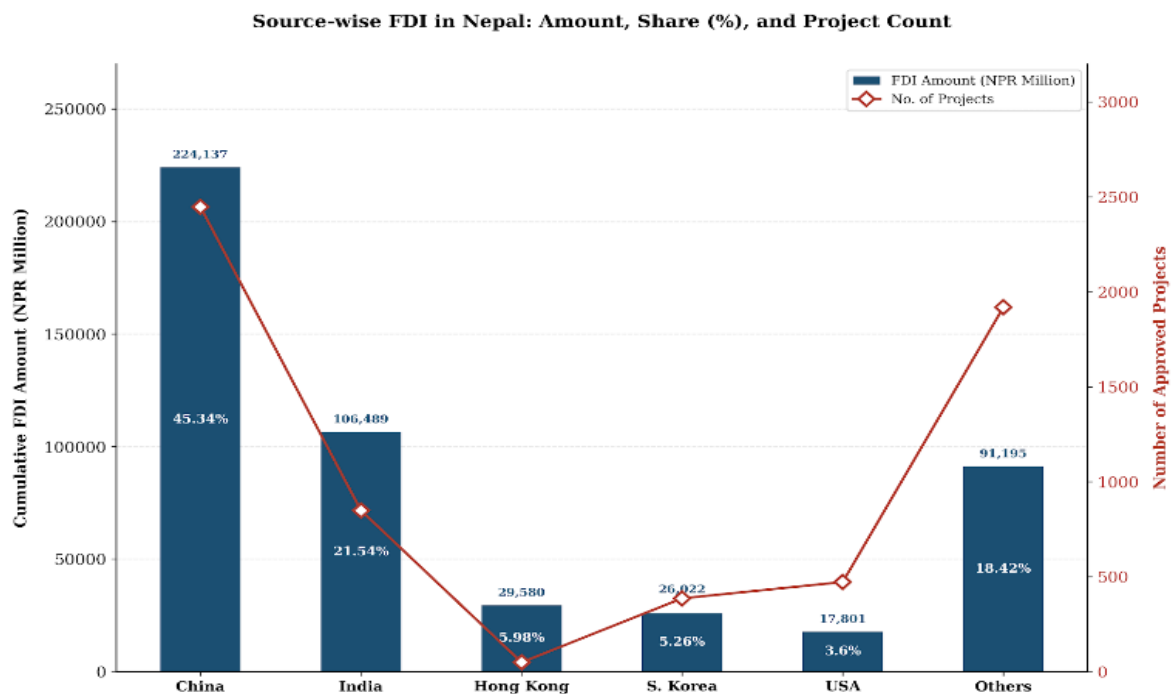


The longitudinal analysis of Nepal's FDI landscape illustrates a significant divergence between institutional approvals and actual capital mobility. As depicted in the figure 1, the trajectory of Approved FDI exhibits substantial volatility, characterized by aggressive spikes that reflect periodic investor interest. Notably, in the 2014/15 fiscal year, approvals reached a record peak of NPR 67,455.04 million, yet this 'pledged capital' failed to materialize in the domestic economy, as evidenced by the corresponding Actual Net FDI of only NPR 4,382.60million. This disparity identifies a critical "implementation gap" (represented by the shaded region in the figure), suggesting that high-level investment commitments are frequently decoupled from the operational reality of project execution.

The efficiency of Nepal’s investment climate is best quantified by the Realization Percentage, which measures the ratio of actual inflows to approved amounts. The data reveals a regressive trend in this metric; while the 2011/12 period showed a realization rate of 128.8% indicating the entry of deferred capital from previous cycles the subsequent decade has seen a marked decline. By the 2023/24 fiscal year, the realization rate plummeted to a decade-low of 15.9%. This contraction is particularly concerning because it occurs despite a relatively steady volume of new approvals (NPR 44,419.83 million in the same year), indicating that the barriers to entry are becoming more pronounced during the post-approval phase. Furthermore, the Gap (NPR Million) column highlights the mounting opportunity cost of unrealized investments. The peak deficit in 2014/15 of over NPR 63 billion underscores a systemic failure in converting investor interest into productive assets. Even in more stable periods, such as 2020/21, the gap remained significant at NPR 12,560.10 million, despite a localized recovery in the realization rate to 60.8%. The persistent nature of this gap across thirteen fiscal cycles suggests that the primary constraint on Nepal’s FDI growth is not a lack of international interest, but rather an institutional inability to bridge the divide between legal approval and physical capital injection. This ‘Commitment-Realization Paradox’ serves as a primary indicator of the structural and bureaucratic hurdles that continue to stifle Nepal’s economic integration.

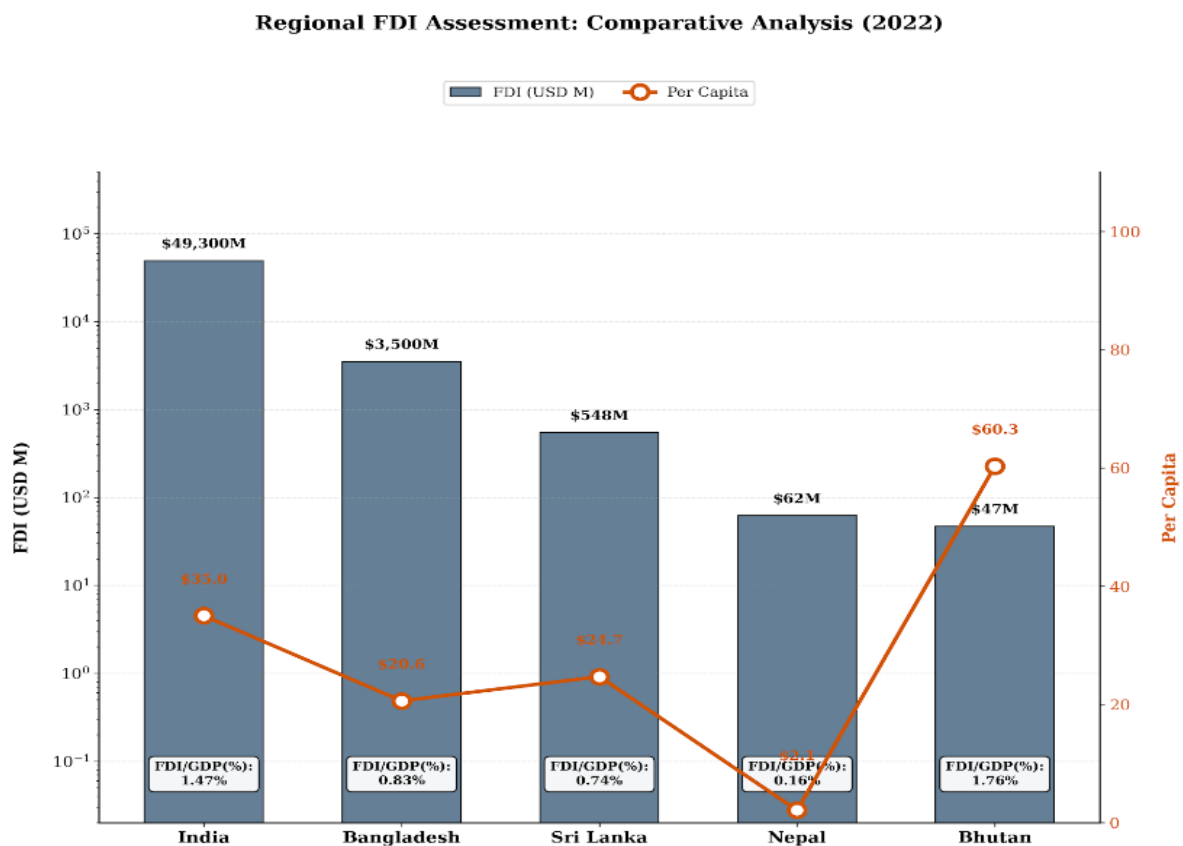
The bilateral investment landscape in Nepal is characterized by a significant concentration of capital and project density from a limited number of partner nations. As visualized in the figure 2 ‘Source-wise FDI in Nepal: Amount, Share (%), and Project Count,’ the relationship with neighboring economies remains the primary driver of foreign capital stock. China occupies the most prominent position, accounting for 45.34% of the total FDI share with a cumulative investment of NPR 224,137 million. This financial dominance is matched.

Figure 2. Source-wise FDI in Nepal (DoI, 2024)



by a substantial operational presence of 2,448 projects. India represents the second-largest partner, contributing 21.54% of the share (NPR 106,489 million), though with a lower project density (849 projects), indicating a trend toward larger, individual capital-intensive investments. The secondary tier of investors, comprising Hong Kong (5.98%), South Korea (5.26%), and the USA (3.60%), reveal distinct investment characters. Notably, Hong Kong utilizes a ‘high-value, low-volume’ model, securing a significant share through only 49 projects. Conversely, the USA and South Korea maintain a broader project base relative to their total capital contribution. Collectively, the top five nations account for over 81% of Nepal's total FDI value, underscoring a narrow geographic base that highlights the importance of strategic market diversification to enhance economic stability.

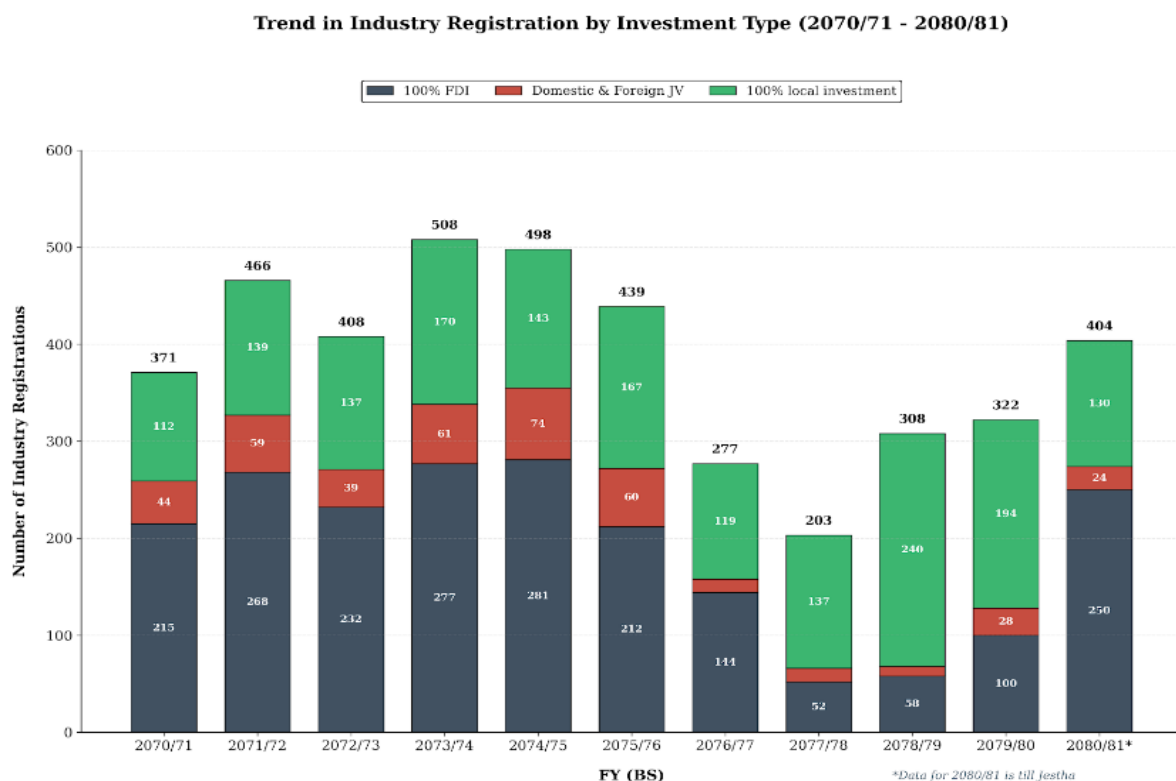
Figure3. Region wise FDI Assessment (NRB, 2024)



The comparative assessment of South Asian economies for 2022 reveals a profound disparity between absolute investment volume and the actual intensity of foreign capital within national borders. While India remains the regional leader in total volume by securing 49,300 million dollars in FDI, figure 3 illustrates the massive scale of its domestic market rather than the specific efficiency of its investment attraction model. A more accurate measure of national competitiveness emerges when evaluating investment through the lens of per capita distribution and its weight relative to the national economy.

From this perspective, Bhutan stands out as the regional benchmark for investment efficiency. Despite possessing the lowest absolute volume in the group at only 47 million dollars, Bhutan achieves a per capita investment of 60.3 dollars and a GDP contribution of 1.76 percent, both of which are the highest in South Asia. This performance proves that being a small or landlocked mountainous nation does not inherently prevent the successful attraction of foreign capital when supported by effective policy frameworks. Nepal represents the lower bound of regional FDI performance, with a per capita investment of merely \$2.1 and an FDI-to-GDP ratio of 0.16%, significantly below Bangladesh (\$20.6) and Sri Lanka (\$24.7). Most notably, Nepal’s investment intensity is approximately thirty times lower than Bhutan’s indicating that its primary constraints are institutional and structural rather than resource based. This underscores a critical commitment- realization gap, wherein the inability to convert investment interest into actual capital inflows remains a fundamental impediment to economic growth (NRB, 2024; World Bank, 2024; UNCTAD, 2024)

Figure 4. Trend of Industry Registration by Investment (DoI, 2024)



The longitudinal tracking of industry registrations, as shown in figure 4, from the fiscal year 2070/71 [2013/14] through to 2080/81 [2023/24] provides a clear window into the shifting confidence levels of both domestic and foreign investors. When looking at the data over this eleven-year period it becomes evident that Nepal experienced a significant era of industrial expansion in the mid-decade before facing a sharp contraction. Between the fiscal years 2073/74 [2016/17] and 2074/75 [2017/18] registrations reached their highest levels with total



project entries consistently staying above the five hundred marks. During this period the market saw a strong balance between solo foreign ventures and local projects which suggested a healthy and maturing industrial ecosystem.

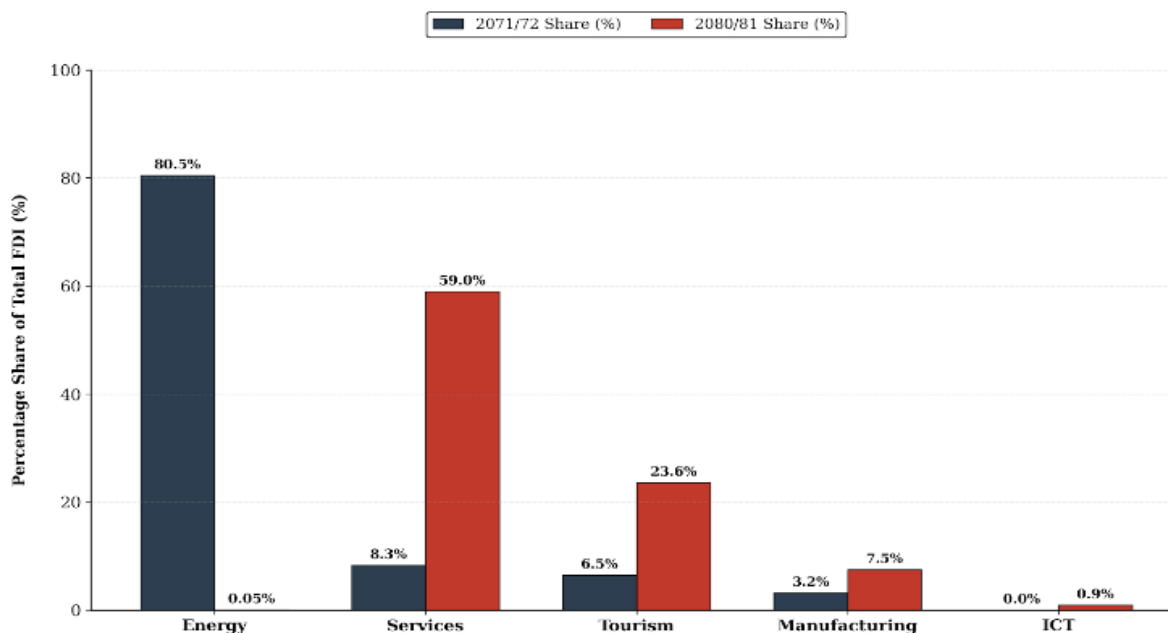
This growth trajectory was severely interrupted during the transition to the 2077/78 [2020/21] period which coincided with global economic disruptions. The data shows that 100% FDI registrations fell to their lowest point of just 52 units while joint ventures almost entirely stalled. It is interesting to note that while foreign interest temporarily waned, the local investment category showed remarkable resilience and even expanded during the 2078/79 [2021/22] period. This suggests that domestic capital attempted to stabilize the industrial sector during a time when international investors were retreating due to global uncertainty. The most striking feature of the current decade is the dramatic recovery shown in the 2080/81 data through Jestha. Solo foreign investment registrations have surged back to 250 units which is nearly a fivefold increase from the pandemic lows. While this indicates a powerful return of international interest the continued stagnation of domestic and foreign joint ventures remains a point of concern. The lack of collaborative projects suggests that foreign capital is increasingly entering the market as isolated entities rather than forming the local partnerships that are often necessary for meaningful technology transfer.

The comparison of sectoral investment shares, as shown in figure 5, between the fiscal years 2071/72 [2014/15] and 2081/82 [2023/24] reveals a complete transformation of the foreign direct investment landscape in Nepal. A decade ago, the energy sector was the primary driver of international capital as it accounted for more than eighty percent of the total investment volume. This overwhelming concentration underscored a period where large scale hydroelectric projects dominated the national economic priority and attracted the vast majority of foreign interest. However, the current data for 2080/81 shows a dramatic migration of capital away from heavy infrastructure toward the service and hospitality industries. The service sector has now become the dominant recipient of investment by claiming nearly sixty percent of the total share which represents a massive increase from its minor position ten years earlier. Tourism has also seen a significant rise in its relative importance by growing from a small six percent share to nearly a quarter of all foreign investment.

This sectoral pivot suggests that the nature of investment in Nepal is becoming more diversified and focused on the tertiary economy rather than remaining tethered to a single resource dependent sector. While manufacturing and information technology still represent smaller portions of the overall pie their steady growth indicates an economy that is slowly broadening its industrial base. The almost total disappearance of energy from the new investment registrations in the current fiscal year highlights a critical transition phase where the national focus has shifted from power generation to service delivery and tourism infrastructure.

Figure5. Shift in Sectoral FDI Distribution (DoI, 2024)

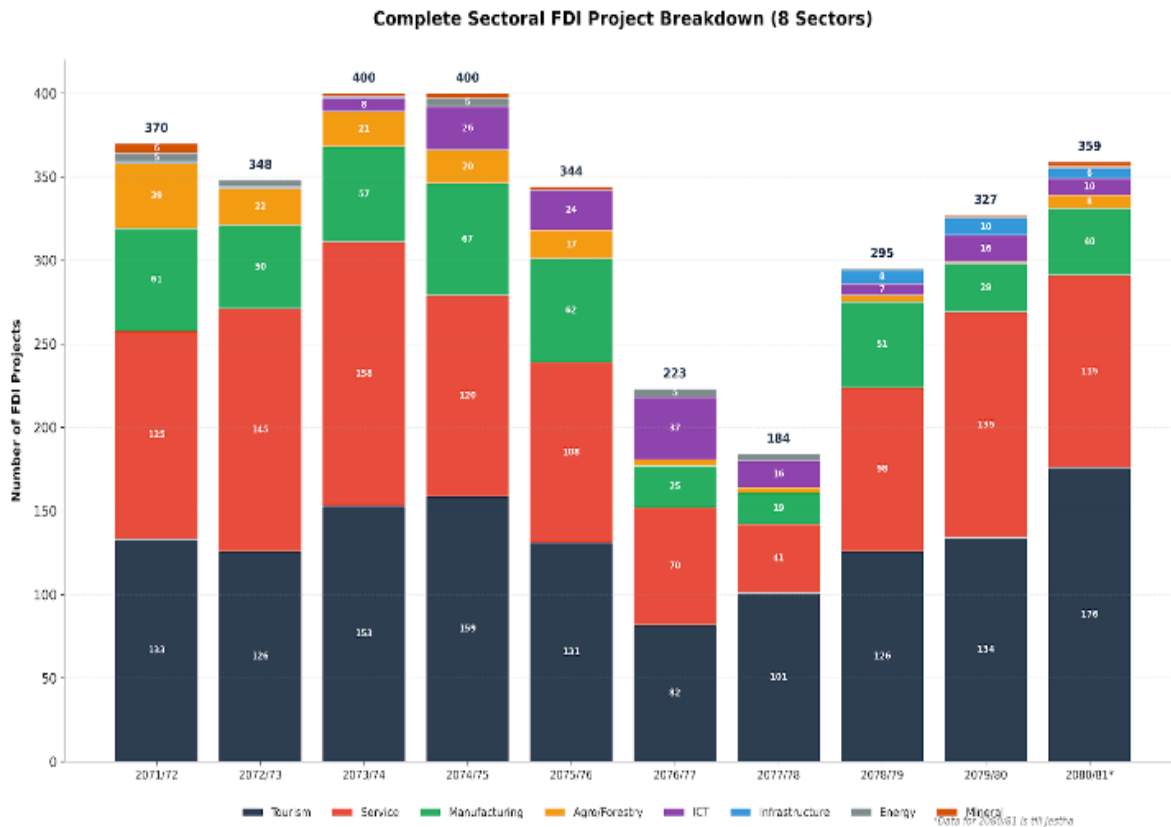
Shift in Sectoral FDI Distribution: 2071/72 vs. 2080/81



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Figure 6: Sectoral FDI Project Breakdown (DoI, 2024)



The comparison of sectoral project registrations between the fiscal years 2071/72 [2014/15] and 2080/81 [2023/24] reveals a profound structural realignment of foreign investor preference in Nepal. A decade ago, the investment landscape was characterized by a more balanced distribution of interest across the economy. During this earlier period, the productive and primary sectors specifically manufacturing and Agro-Based industries held a robust collective share of the project portfolio. This reflected an investment climate where international interest was effectively anchored in tangible production and the exploitation of Nepal's agricultural potential, suggesting a diversified and production-oriented approach to market entry. However, the current data for 2080/81 [2023/24] illustrates a dramatic migration of entrepreneurial energy toward the tertiary economy, specifically the Tourism and Service sectors. The Tourism sector has now established an overwhelming hegemony over the project landscape, as shown in figure 6, surging from 133 to 176 distinct projects in a decade. This represents a massive consolidation of foreign interest into the hospitality trade, signaling that Nepal is now primarily viewed as a destination for service-oriented capital. Simultaneously, the Service sector remains a powerhouse of project volume, consistently accounting for over a hundred new registrations annually. This sectoral pivot suggests that while the 'number' of investments is at an all-time high, the nature of that investment is becoming increasingly concentrated in "soft" infrastructure. The traditional pillars of the industrial base have seen a relative retreat: the Agro-Forestry sector has witnessed a precipitous decline from a healthy presence a decade ago to a

marginal fraction today, while Manufacturing has struggled to regain its earlier momentum. Furthermore, the negligible project counts in Energy and Infrastructure highlight a critical divergence in the FDI story: while these sectors still attract the largest ‘monetary’ commitments, they have almost entirely disappeared from the ‘frequency’ of new project registrations. This underscores a transition phase where Nepal’s day-to-day investment activity has shifted from building a productive industrial base to expanding the reach of its hospitality and service ecosystems.

Figure 7. FDI Projects by Investment Scale(NRB, 2024)

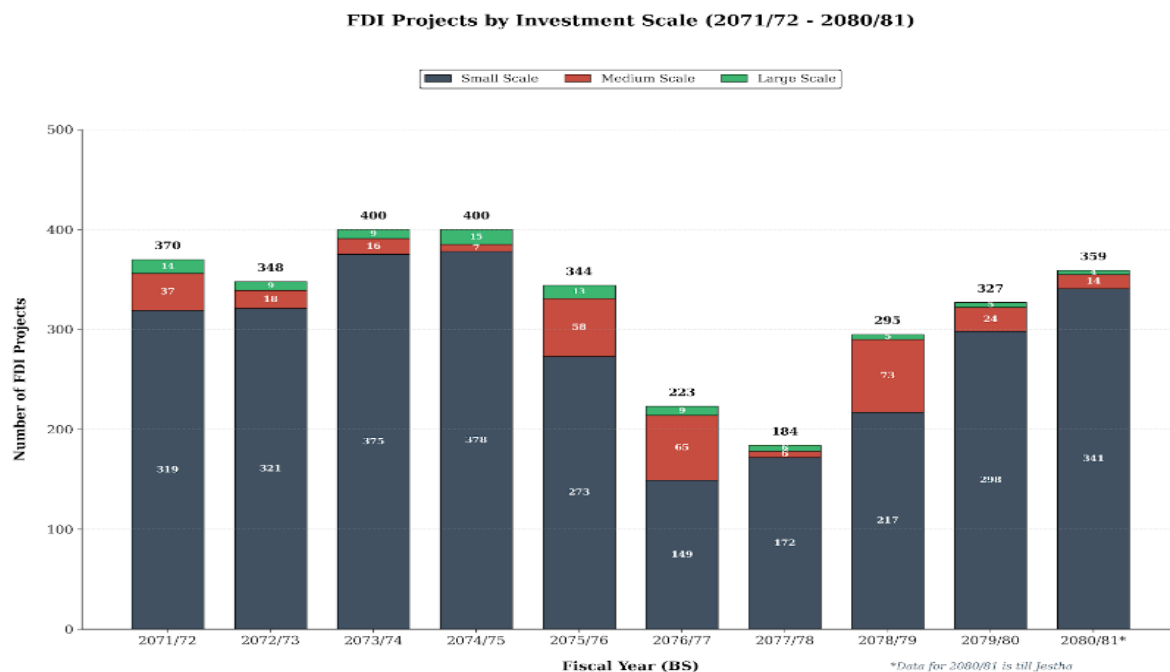


Figure 7 demonstrates the distribution of FDI projects in Nepal by investment size over a decade, revealing several key patterns. Total FDI project peaked at 400 in Both 2073/74 [2017/18] and 2074/75 [2018/19] then declined sharply to 184 projects in 2077/78 [2021/2022] (the lowest point), before gradually recovering to 359 projects by 2080/81 [2023/24]. Small-scale investment consistently represents the largest share, accounting for 80-95% of all projects across most years. For example, small-scale projects numbered 375 in 2073/74 [2017/18] and 341 in 2080/81 [2023/24], demonstrating their dominant role in Nepal’s FDI landscape. Medium-scale projects show moderate presence, ranging from 18-73 projects annually, with notable peaks in 2075/76 [2019/20] (58 projects) and 2078/79 [2022/23] (73 projects). Large-scale investment remains minimal throughout the period, never exceeding 18 projects in any fiscal year, indicating Nepal’s challenge in attracting major foreign investments.

5. The Commitment- Realization Gap: A Critical Assessment

The most critical challenge is the substantial disparity between approved commitments and actual inflows. Nepal faces a severe disconnects between approved FDI and actual investment. Data from 2068/69 [2012-2013] to 2080/81 [2023/24] shows that only 25-30% of approved commitments materialize into real capital inflows, revealing a fundamental weakness in



Nepal's investment climate (DoI, 2024). Figure 1 illustrates this problem clearly in 2071/72 [2014/15], Nepal approved NPR 67,455.04 million but received only NPR 4382.60 million a mere 6.5% realization rate (DoI, 2024). Similarly, 2080/81 saw approved commitments of NPR 44,419.83 million but yielded just NPR 7,047.40 million (15.9%) between mid-July 2023 and mid-May 2024. Nepal realized only 14.99 percent of FDI commitments (NRB, 2024). While 2069/70 [2013/14] showed an unusually high 128.8% realization, this reflects delayed implementation from previous years rather than new investments. The median realization rate over thirteen years stands at 38.8%, which means that over 60% of approved investments never materialized. Cumulatively, Nepal approved NPR 425,426.09 million but actualized only NPR 148,875.52 million with a shortfall of NPR 276,550.57 million (DoI, 2024). This represents massive lost opportunities for infrastructure development, employment and technology transfer.

Multiple factors associate to this gap. FDI approval may simply indicate an intended investment that may not actually take place, there may be significant time lags between approval and actual investments and in some instances the realization of approval investment may take several years, particularly for projects with longer gestation periods (NRB, 2024; Nepal Economic Forum, 2024). At the project level, weak feasibility studies, overly optimistic projections, changing business conditions and financing difficulties prevent implementation. Institutionally, post-approval clearance involves lengthy delays across multiple agencies, incentives are applied inconsistently, regulations change during implementations and inter-agency coordination remain poor (Adhikari & Shrestha, 2023). Infrastructure and market constraints further compound the problems. Despite improvements, electricity supply remains unreliable for industrial use, road networks are inadequate, industrial land with clear titles is scarce and domestic markets are limited (Bhattraï, 2011). Financial barriers include complex profit repatriation procedures, cumbersome foreign exchange regulation, insufficient long-term financing for domestic banks and broader global economic uncertainties (NRB, 2024).

5.1 Sectoral Evaluation and Structural Transformation

Nepal's FDI has undergone a dramatic sectoral shift over the past decade. In 2071/72 [2014/15], energy dominated with 80.5% of total FDI (NPR 54,287 million), reflecting government priorities to address electricity shortages through hydropower development (DoI, 2024). Services accounted for only 8.3%, tourism 6.5% and manufacturing just 3.2%. By 2080/81 [2023/24], this pattern reversed completely. Services became the leading sector at 59.0% (NPR 10,486 million) (DoI, 2024). Manufacturing rose modestly to 7.5%, and Information and Communication Technology [ICT] emerged at 0.9%. Most notably, energy collapsed to just 0.05% an 80.45% point decline. This shift reflects multiple factors: completion of major hydropower projects, increased domestic capacity for medium scale energy investment and difficulties in power purchases negotiations (NRB, 2024). The services expansion encompasses banking, real estate, healthcare and education driven by Nepal's growing middle class and urbanization. Tourism growth demonstrates investor confidence in Nepal's post-earthquake recovery and natural assets.



However, these transformations raise concerns. The manufacturing sector's mere 7.5% share is insufficient for structural economic transformation, as manufacturing typically offers superior technology transfer, skill development and export diversification compared to services (Gorg & Greenaway, 2004). Project level data reveals tourism leads with 2,126 projects (34.2%), followed by services with 2071 [2014] projects (33.3%), while energy accounts for only 93 projects despite its former dominance (DoI, 2024). Scale analysis shows concerning patterns too: small projects (below NPR 100 million) numbered 5247 (84.4% of total), while large projects (exceeding NPR 1 billion) totaled only 331 (5.3%). This indicates that Nepal attracts numerous small ventures but struggles to secure transformative large-scale investment (DoI, 2024).

5.2 Geographic Concentration and Source Country Analysis

Nepal's FDI exhibits substantial geographic concentration. China and India together account for NPR 330,626 million or 66.88% of cumulative FDI through 2080/81 [2023/24] (DoI, 2024). China leads with NPR 224,137 million (45.34%) across 2,448 projects, initially in infrastructure and energy but increasingly diversified into manufacturing and services. India contributes NPR 106,489 million (21.54%) through 849 projects, with higher average project values suggesting medium to large scale ventures. Other sources include Hong Kong (NPR 29,580 million, 5.98%), South Korea (NPR 26,022 million, 5.26%), and the United States of America (NPR 17,801 million, 3.60%). The top five countries represent 81.7% of total FDI, leaving only 18.3% from all other sources (DoI, 2024). This concentration creates vulnerabilities. Bilateral tensions with China or India could drastically reduce inflows, while economic downturns in these countries directly impact Nepal's prospects (Khanal & Khanal, 2010). A concrete example occurred in the hydropower sector, where India refused to buy electricity from any projects involving Chinese participation due to rising India-China tensions directly limiting Nepal's export market and discouraging Chinese investment in this sector (Global Voices, 2025). Similarly, economic slowdowns in China and India directly affect Nepal's investment prospects. During 2021/22, Nepal's exports to China fell by 21.4% amid China's economic challenges (Johny, 2024; Nepal Economic Forum, 2024). More recently, by October 2014, China became Nepal's second-largest exporter with an 85.3% increase in exports to Nepal from the previous year, while India remained the top trading partner (NRB, 2024; Vivekananda International Foundation, 2025), showing how economic shifts in these countries immediately impact Nepal.

Another risk emerges from sectoral concentration. Both Chinese and Indian investors often favor the same industries particularly services, tourism and manufacturing creating potential overcrowding in certain sectors while leaving others underdeveloped (DOI, 2024). As of mid-July 2023, India held the largest FDI stock at USD 750 million, followed by China with USD 260 million (South Asian Voices, 2025), demonstrating this dual dependence. Regional comparison reveals Nepal's underperformance. Nepal's USD 62 million FDI in 2022 represented only 0.16% of GDP and USD 2.1 per capita, far below regional peers (UNCTAD, 2023; World Bank, 2023). India received USD 49,300 million (1.47% of GDP), Bangladesh USD 3,500 million (0.83% of GDP), and Sri Lanka USD 548 million (0.74% of GDP). Most



notably, Bhutan achieved USD 47 million representing 1.76% of GDP and USD 60.3 per capita the highest per capita FDI in South Asia (UNCTAD, 2023). Bhutan's success through focused hydropower development and stable policies demonstrates Nepal's significant untapped potential despite comparable landlocked, mountainous challenges (Collier, 2007).

5.3 Temporal Trends and Investment Dynamics

Nepal's FDI inflows show high volatility, with distinct phases shaped by external shocks and policy changes. From 2068/69 [2011/12] to 2071/72 [2014/15], FDI remained relatively stable at approximately NPR 6,500 million annually, focused on hydropower and manufacturing (DoI, 2024). However, 2072/73 [2015/16] saw a sharp drop to NPR 3,194.60 million due to the April 2015 earthquakes and subsequent India- Nepal border blockade (NRB, 2024). Recovery began in 2073/74 [2016/17] with inflows of NPR 5,920.90 million, accelerating to an average of NPR 14,000 during 2074/75 [2017/18]- 2077/78 [2020/21] as earthquake reconstruction attracted construction, hospitality, and infrastructure investments (DoI, 2024). FDI peaked at NPR 19,478.70 million in 2077/78 [2020/21], driven by hydropower projects, tourism development and improved political stability following federal elections. Since then, a concerning decline has emerged: FDI fell to NPR 7,768.60 million in 2080/81 [2022/23] and further to NPR 7,047.40 million in 2081/82 [2023/24] (DoI, 2024). This sustained decrease, despite reform like the 'One stop Service Centre' and 'Automatic Route' approval, raises question about Nepal's fundamental investment attractiveness.

Ownership patterns reveal weakening foreign-domestic collaboration. Fully foreign owned enterprises comprised 61.9% of registrations in 2080/81 [2023/24] versus 57.5% in 2071/72 [2014/15], while joint ventures declined from 12.7% to just 5.9% (DoI, 2024). This trend is concerning because joint ventures typically facilitate greater technology transfer, skill development and local supply chain integration compared to wholly foreign-owned firms (Borensztein et al, 1998). Project scale analysis shows a troubling pattern. Small projects dominate numerically with 5,247 registrations (84.4%), but large projects numbered only 331 (5.3%) over the period. Large project approvals declined from 14-15 annually to just 4-5 recently, explaining much of the FDI decline. This indicates Nepal increasingly attracts small commercial ventures while falling to secure transformative infrastructure, manufacturing or technology investments (DoI, 2024).

6. Challenges and Constraints: A Multi-Dimensional Analysis

Despite progress in electricity access, Nepal's energy infrastructure remains a significant FDI constraint. Installed capacity reached 3,175 MW by 2024, yet industrial load shedding was reintroduced in December 2024 due to seasonal hydropower shortfalls, with irregular supply persisting in major industrial hubs (NEA, 2024; World Bank, 2024). Industrial tariffs of NPR 9.21 per/kwh further reduce Nepal's competitiveness relative to regional peers constituting a structural impediment to FDI attraction (Global petrol press, 2025). Transportation infrastructure severely limits investment. Nepal has only 35000 km of roads with 60% all-weather accessibility, compared to Bhutan's 95% despite similar terrain (Bhattra Rai, 2011). Transit times from Kathmandu to Indian industrial centers exceed 36-48 hours. Air cargo



capacity is extremely limited at 45000 tons annually, versus 300000 plus tons at regional airports, while rail connectivity is virtually absent with only 59 km operational compared to Bangladesh's 2600km(NRB, 2024). Industrial infrastructure is inadequate. Organized industrial estates cover only 1800 hectares with three-year waitlists, lacking comprehensive utilities and facilities. Special Economic Zones remain largely conceptual despite 2016 legislation (DoI, 2024). Digital infrastructure shows uneven progress with 78% internet penetration nationally but quality varies dramatically, with fiber optic coverage limited to major urban centers only (Nepal Telecommunications Authority, 2024).

Policy implementation suffers from inconsistencies. While the One Stop Service Centre and Automatic Route have improved approvals, post approval compliance involves navigating multiple agencies with conflicting requirements (Adhikari & Shrestha, 2023). Environmental clearances take 6-12 months and VAT refund processing averages 12-18 months versus the legal 60 day mandate (DoI, 2024). Tax incentive eligibility faces disputes over 'priority sector' definitions. Customs procedures for duty free machinery require 3-6 weeks despite facilitation commitments. Frequent regulatory changes, particularly in telecommunications and financial services, create uncertainty (NRB, 2024). Intellectual property enforcement remains weak despite TRIPS- compliant legislation, with counterfeit products proliferating and digital piracy inadequately addressed (Adhikari & Shrestha, 2023).

Investment facilitation institutions face severe capacity limitations. The Department of Industry operates with fewer than 150 central staff and limited provincial presence, facing 25- 30% annual turnover that disrupts continuity (DoI, 2024). Inter-agency coordination remain weak OSSC coordinated 14 agencies for approvals, but post- approval involves dozens more with un-integrated system requiring duplicate documentation. Nepal's 2015 federalization devolved authorities to provinces and 753 local governments, yet most lack investment promotion expertise, creating highly variable procedures and unpredictable regulatory landscapes (Sharma & Khanal, 2022). Monitoring and aftercare systems are underdeveloped with grievance mechanisms operating reactively rather than preventively (DoI, 2024).

Nepal's limited market size has economic and market constraints that constrains investment. With 30 million population, USD 1336 per capita GDP, and dispersed settlements, Nepal offers restricted potential versus India's 1.4 billion consumers or Bangladesh's urban concentration (World Bank, 2023). Export procedures average 15-20 days versus 5-7 days in comparator countries, with border delays and third country routing adding costs. Finance access is challenging. Domestic banks prefer short term lending, with industrials interest rates of 12-14% versus 7-9% in India and Bangladesh (NRB, 2024). Foreign exchange transactions involve complex procedures taking weeks. The shallow capital market has only 232 listed companies with limited equity financing options. Labor dynamics present mixed prospects. Competitive wages of USD 120-150 monthly match Bangladesh, but skilled labor shortages are acute (World Bank, 2023). Annual emigration of 300,000- 400,000 workers drains the productive pool, while vocational training produces only 30,000 graduates annually against industrial demand (Ministry of Labour, 2024).



Political stability improved post-2015, yet governance challenges persist. Five governments between 2017-2024 created policy continuity concerns with high cabinet turnover disrupting investors (Sharma & Khanal, 2022). Corruption improved from 146th (2012) to 110th (2023) in Transparency International rankings, but petty corruption persists in land registration, customs and permits (Transparency International, 2023). Federal transition challenges continue. Overlapping jurisdictions in industrial registration, environmental clearance, and land use create confusion, with some local governments imposing additional fees beyond federal regulations (DoI, 2024). While major violence ceased post-2006, occasional strikes disrupt border transit. Commercial dispute resolution averages 3-5 years with limited alternative mechanisms (Adhikari & Shrestha, 2023).

7. Policy Implications and Strategic Pathways

The findings of this study demonstrate that Nepal's persistent gap between approved and realized FDI is fundamentally rooted in structural, institutional, and infrastructural constraints, reinforcing the central argument in the literature that location advantages and institutional quality critically shape investment outcomes in developing and landlocked economies (Dunning, 1980; Vijil & Wagner, 2012). Addressing these constraints requires a coordinated and sequenced policy approach that prioritizes infrastructure development, regulatory effectiveness, institutional strengthening, sectoral competitiveness, and investment climate reforms.

Infrastructure development represents a foundational priority for improving Nepal's investment attractiveness and enhancing realization rates. Persistent deficits in transport connectivity, logistics, energy reliability, and digital infrastructure continue to increase operational costs and investment risks, thereby weakening Nepal's location advantages relative to competing economies in South Asia. Strategic investments in North–South economic corridors, international airport cargo capacity, and cross-border railway connectivity; particularly the Raxaul–Kathmandu railway are essential for reducing transit dependency and improving integration into regional and global value chains (NPC, 2020; DoI, 2024). Equally important is the development of fully serviced industrial estates and operational Special Economic Zones (SEZs) with transparent governance and streamlined customs procedures, which international experience identifies as critical instruments for attracting export-oriented FDI. Digital infrastructure expansion, including nationwide high-speed broadband, domestic data centers, and strengthened cyber security frameworks, is necessary to position Nepal competitively in emerging ICT and service-based investment sectors (Nepal Telecommunications Authority, 2024). Reliable and diversified energy infrastructure, including dedicated industrial feeders and renewable energy integration, is equally essential for ensuring uninterrupted industrial operations and investor confidence (NRB, 2024).

However, infrastructure investment alone is insufficient without parallel reforms addressing regulatory inefficiencies and post-approval barriers that contribute significantly to Nepal's commitment–realization gap. This study's findings confirm that delays in land acquisition, environmental clearances, and administrative approvals undermine investment implementation



despite improvements in initial approval procedures. Establishing legally mandated timelines for key approvals, expanding single-window systems beyond approval stages, and digitizing land administration through a national land bank system would substantially reduce transaction costs and uncertainty (NPC, 2020; Adhikari & Shrestha, 2023). Strengthening intellectual property protection, customs enforcement, and dispute resolution mechanisms including specialized commercial courts and expedited arbitration procedures would further enhance Nepal's institutional credibility and investor confidence.

Institutional capacity strengthening across federal, provincial, and local levels is equally critical. The Department of Industry and Investment Board Nepal require enhanced technical capacity, professional staffing, and performance monitoring systems to effectively manage investment facilitation and implementation (DoI, 2024). Establishing comprehensive investor aftercare services, digital project tracking platforms and formal grievance redress mechanisms can identify implementation bottlenecks early and improve realization rates. Strengthening provincial and local government capacity is particularly important in Nepal's federal governance system, where implementation responsibilities are increasingly decentralized. International evidence suggests that investment promotion agencies with strong technical capacity and institutional autonomy play a decisive role in improving investment outcomes (Sharma & Khanal, 2022; UNCTAD, 2023).

The sectoral distribution of FDI also requires strategic reorientation toward high-impact and productivity-enhancing sectors. While Nepal has attracted investment primarily in tourism and services, the development of export-oriented manufacturing including agro-processing, pharmaceuticals, garments, and light engineering—offers significant opportunities for employment generation, technology transfer, and export diversification (Ministry of Industry, 2020; FITTA, 2019). Similarly, strengthening Nepal's ICT ecosystem through technology parks, startup support mechanisms, and diaspora engagement can position the country within global digital service value chains (DoI, 2024). Renewable energy diversification beyond hydropower, including solar and wind energy development and regional electricity trade, offers additional opportunities for attracting strategic investment and expanding export potential (NRB, 2024). Tourism development strategies must prioritize quality, sustainability, and value addition to maximize economic benefits while ensuring environmental and social sustainability (Nepal Tourism Board, 2024).

Geographic diversification of investment sources represents another critical priority. This study confirms Nepal's high dependence on a limited number of countries, particularly India and China, which increases vulnerability to geopolitical and economic fluctuations. Expanding investment partnerships with technologically advanced economies such as Japan, South Korea, European Union countries, and the United States can diversify investment risks while facilitating technology transfer and institutional learning (Khanal & Khanal, 2010; UNCTAD, 2023). Strengthening diplomatic economic engagement, investment promotion activities, and bilateral investment agreements can support this diversification. Moreover, Nepal's diaspora represents an important yet underutilized source of investment capital, knowledge, and global



networks, which can be mobilized through targeted incentives, investment instruments, and engagement platforms (DoI, 2024).

Finally, improving Nepal's overall investment climate requires strengthening governance transparency, judicial effectiveness, and anti-corruption efforts. Publishing investment regulations in English, ensuring regulatory consistency, strengthening contract enforcement, and expanding digital governance systems can reduce uncertainty and improve investor perceptions (Adhikari & Shrestha, 2023; Transparency International, 2023). Sustained anti-corruption measures, including improved investigation capacity, transparency mechanisms, and accountability see essential for enhancing Nepal's credibility as an investment destination (World Economic Forum, 2023; UNCTAD, 2023). These reforms collectively address the structural and institutional constraints identified in this study and are essential for improving both FDI attraction and realization.

8. Conclusion

This study provides a comprehensive empirical and institutional analysis of FDI trends, realization patterns, and policy effectiveness in Nepal, addressing critical gaps in the existing literature. Consistent with theoretical and empirical insights from international investment literature, the findings demonstrate that while Nepal has made significant progress in liberalizing its investment regime and improving approval procedures, structural and institutional constraints continue to limit its ability to translate investment commitments into actual capital inflows (Dunning, 1980; Borensztein et al., 1998). The persistent commitment–realization gap, with only a fraction of approved investments materializing, reflects systemic implementation weaknesses rather than a lack of investor interest. These weaknesses include inadequate infrastructure, regulatory inefficiencies, institutional capacity limitations, and policy implementation gaps. The study further reveals that Nepal's FDI remains concentrated in a limited number of sectors and source countries, reflecting both structural constraints and strategic limitations. This concentration increases economic vulnerability and limits the broader developmental benefits of FDI, including technology transfer, employment generation, and export diversification. Despite recent policy reforms such as FITTA 2019, the Industrial Enterprises Act 2020, the One Stop Service Centre, and the Automatic Route mechanism, implementation challenges continue to constrain investment outcomes. These findings reinforce broader evidence from landlocked developing countries that institutional effectiveness and implementation capacity are decisive factors in determining FDI performance (Collier, 2007; Vijil & Wagner, 2012).

The study contributes to both academic and policy debates by demonstrating that improving FDI outcomes in Nepal requires shifting policy focus from regulatory liberalization toward effective implementation, institutional strengthening, and infrastructure development. Nepal's relatively low FDI performance compared to regional peers such as Bangladesh and Sri Lanka suggests significant untapped potential that can be realized through strategic reforms and sustained implementation efforts (UNCTAD, 2023; World Bank, 2023). Strengthening institutional coordination, improving infrastructure, enhancing regulatory efficiency, and



diversifying investment sources are essential for closing the commitment–realization gap and maximizing the developmental impact of FDI. At a broader level, the findings highlight the importance of governance quality and institutional effectiveness in shaping investment outcomes in developing and landlocked economies. Nepal possesses significant structural advantages, including abundant natural resources, a young labor force, and strategic geographic proximity to major markets. However, realizing this potential requires sustained political commitment, institutional reform, and policy coherence. By addressing the structural and institutional constraints identified in this study, Nepal can transform FDI from a relatively underperforming component of its development strategy into a central driver of economic growth, structural transformation, and long-term development.

Future research should build upon this study by examining firm-level investment experiences, comparative analysis with successful landlocked economies, and rigorous impact assessment of recent investment policy reforms. Such research would further deepen understanding of the institutional and political economy dynamics shaping investment realization and development outcomes.

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