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Strategies and Trends: Evaluating Chinese Investments in Nepal

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A

bstract

The policy brief examines China's multifaceted investments in Nepal, detailing historical shifts, strategic interests, and the geopolitical context. Focused on sectors like services, hydropower, and manufacturing, the analysis highlights challenges including political instability and investor confidence issues due to policy fluctuations. Existing legal frameworks and policy changes are explored, emphasising revisions to attract foreign direct investment (FDI). Trends reveal a surge in Chinese commitments since 2012, with discrepancies between pledges and actual projects. State-owned enterprises dominate critical infrastructure projects, while private companies invest in micro-enterprises. Recommendations include sectoral diversification, strengthened democratic institutions, and improved monitoring to address illegal activities.

Introduction

In the realm of international relations, it is widely recognised that Foreign Direct Investment (FDI) plays a pivotal role in fostering economic growth, particularly in developing countries. Traditionally, the flow of FDI has followed a pattern from developed to developing nations, a trend that has endured since the post-World War II period. However, historical exceptions challenge this norm. Notably, in the 18th century, the United Kingdom attained developed status without relying on foreign investments.

Fast forward to the 21st century, where China defies conventional expectations by emerging as an exception to the traditional FDI flow. Despite being a developing country, China has become a major player in high-volume investments, both in developed and developing countries. The significant volume of both inflow and outflow investments from China has raised concerns globally. In the 1980s, China was the largest recipient of FDI, impacting the global economy, security, and politics. Concurrently, Chinese investments in certain regions are viewed as strategic moves, with investments in South Asia perceived as encircling India, while the primary destinations for China's overseas direct investments include the United States, Europe, and Australia.¹

Nepal, too, has experienced a noteworthy surge in Chinese investment since 2012, surpassing India as its largest investor in 2013. These investments encompass diverse sectors such as infrastructure, hydro energy, telecommunications, tourism, services, and manufacturing. While China asserts that its investments hold the potential to contribute to Nepal's economic development and infrastructure growth, it is imperative to scrutinise the policies and patterns governing these investments to ensure their sustainability, transparency, and alignment with Nepal's national development priorities.

¹ David Dollar, "China as a Global Investor", *Asia Working Group Paper 4*, May 2016, Brookings, Washington DC, p-03.

Against this backdrop, this policy brief aims to analyse the objectives, nature, and impact of financial investments² in Nepal from China, particularly in the post-political transition period since 2008. Recent studies in Nepal have posited that the perceived political and economic shortcomings of India in Nepal have facilitated increased Chinese investments. This brief seeks to delve into the complexities of Nepal-China relations in the wake of evolving investment dynamics, providing insights that are crucial for assessing the broader implications on Nepal's economic and political landscape.

Investment Patterns in China

In a remarkable departure from its commitment to socialism and communism, China embarked on economic reforms in 1979, drawing inspiration from strategies previously tested in the USA. This hybrid approach, blending elements of communism (politically) and capitalism (financially), proved instrumental in attracting foreign capital and technology to fulfill the aspirations of its populace. The appeal for foreign investors stemmed from a combination of factors, including guaranteed political stability, a streamlined single-window project clearance mechanism, cost-effective labour, access to a vast market, and an overarching state-controlled judiciary. By the end of 2022, China had amassed an impressive US\$189.13 billion in foreign direct investment (FDI), exhibiting a year-on-year growth rate of 8 percent—far surpassing the achievements of many other developing countries. Notably, China's outward investment also made a significant mark, reaching approximately US\$146.5 billion in 2022. This dual achievement underscores China's prowess in fostering both inbound and outbound investments, solidifying its position as a global economic powerhouse.³

China's Inflow and Outflow FDI Dynamics

China stands as a unique case among developing nations, witnessing simultaneous increases in both inflow and outflow of investments following two decades of economic reforms. The Chinese government played a proactive role in stimulating overseas investments, particularly through State-Owned Enterprises (SOEs). While some Chinese private companies ventured into overseas investments, the government favoured SOEs, aligning them with its political, economic, and strategic objectives. Given the centralised control of the state and government by a single party, all forms of overseas investments, including those by private businesses, were regulated. In this context, both private enterprises and SOEs implemented the government's strategic directives. Although China largely adopted overseas investment patterns prevalent in the ASEAN region, its approach was distinct due to the active authoritarian involvement of the state. Since the 1990s, the government has played a pivotal role in identifying sectors for overseas investment, guided by China's long-term strategies encapsulated in the “two resources (capital/technology and raw material) two markets (domestic and international)” principles.⁴

² The paper only discusses about the China's financial investment both by the private companies and state owned enterprises (SOEs) of China in Nepal. This does not discuss regarding Chinese official development assistance, loans and trade with Nepal.

³ “Annual outflow of foreign direct investment (FDI) from China between 2012 and 2022”, Statista, <https://www.statista.com/statistics/858019/china-outward-foreign-direct-investment-flows/#:~:text=Annual%20FDI%20outflows%20from%20China%202012%2D2022&text=According%20to%20preliminary%20data%2C%20the,billion%20U.S.%20dollars%20in%202022>. (accessed on 25 December 2023)

⁴ Mark Yaolin Wang, “The Motivations Behind China's Government-Initiated Industrial Investments Overseas”, *Pacific Affairs*, Vol. 75 (2), Summer 2002, p.194.

A comprehensive study revealed that the surge in FDI outflow from China was driven by political, strategic, and economic motives. Economically, as domestic investment opportunities dwindled due to excess capacity and declining profitability, the outflow of capital from China increased. Politically, China sought to bridge the gap between developing countries' aspirations and delivery deficits within the global norms. This involved investing in areas with poor governance systems and overlooking environmental and social safeguards. Such a policy enhanced China's popularity in developing countries by ensuring faster project delivery and securing a supply of natural resources for its domestic industries.⁵ Strategically, investments were made to develop infrastructure in developing countries, identifying strategic locations to support Chinese merchant and naval vessels. This approach addressed infrastructure deficits in developing nations while concurrently bolstering China's soft power and strategic depth. However, the implementation of these tactics varied globally based on China's interests at the global, regional, and domestic levels of the host country.

Examining the motivation behind China's aggressive investments in other countries, Mark Yaoling Wang noted that since the 1980s, China actively encouraged its manufacturers to invest overseas, orchestrating Chinese transnational activities deliberately and strategically. As indicated in Table 1, Chinese FDI primarily focused on Asian and African regions, with a combined purpose of accessing markets, technology, and resources. Additional motivating factors included sluggish domestic demand since the early 1990s, prompting the Chinese central government to advocate for a "going out policy," encouraging enterprises to invest overseas.

Table 1: Chinese Investments in Major Destinations

(US\$ million)

| | 1978-1990 | | 1991-1997 | | 1978-1997 | |
|--------------------|---------------|---------------|---------------|---------------|---------------|---------------|
| Regions | 1028.7 | 100.0% | 1319.9 | 100.0% | 2335.1 | 100.0% |
| N. America | 41.7 | 33.2% | 385.3 | 29.2% | 727.0 | 31.1% |
| -Canada | 53 | 0.5% | 298.6 | 22.6% | 351.6 | 15.0% |
| -USA | 288.7 | 28.1% | 86.7 | 6.6% | 375.4 | 16.1 |
| Asia | 191.1 | 18.6% | 299.9 | 22.7% | 491.0 | 21.0% |
| -HK | 98.9 | 9.6% | 118.8 | 9.0% | 217.7 | 9.3% |
| Africa | 50.4 | 4.9% | 200.4 | 15.2% | 250.8 | 10.7% |
| S. America | 56.6 | 5.5% | 164.6 | 12.5% | 221.2 | 9.5% |
| Oceania | 321.1 | 31.2% | 99.2 | 7.5% | 420.3 | 18.0% |
| -Australia | 309.2 | 30.1% | 20.1 | 1.5% | 329.3 | 14.1% |
| Former USSR | 26.8 | 2.6% | 82.6 | 6.3% | 109.4 | 4.7% |
| EU | 30.8 | 3.0% | 53.3 | 4.0% | 84.1 | 3.6% |
| Middle East | 12.7 | 1.2% | 10.3 | 0.8% | 23.0 | 1.0% |
| East Europe | 0.5 | 0% | 6.8 | 0.5% | 7.3 | 0.3% |

Source: Mark Yaolin Wang, FN. 6, p-197.

The aforementioned study further highlighted that several factors motivated Chinese overseas investments, including access to foreign markets, the escalating cost of production, subdued domestic demands, economic and tax policies of host countries, technology accessibility,

⁵ David Dollar, "China as a Global Investor", Asia Working Group Paper 4, May 2016, Brookings, Washington DC, pp-4-5.

resource availability, infrastructure, political structure, and the prospect of ensuring a stable supply of resources to domestic industries.⁶

In alignment with these findings, the China Power Project by Center for Strategic and International Studies (CSIS) emphasised that “Overseas investment offers China an opportunity to not just bolster its own economy but also leverage its economic strength to increase its influence abroad”.⁷

Consequently, Chinese overseas investment pursued dual objectives, aiming to fulfill both economic and strategic goals, as directed by the state over time. This multifaceted approach underscores China’s intention to not only enhance its economic standing but also strategically leverage its international economic influence.

Key Mechanisms Regulating China’s Overseas Investments

1. The Ministry of Foreign Trade and Economic Corporation (FTEC)
2. The State Economics and Commerce Commission (EACC)
3. Respective Chinese Missions in targeted country for local information.
4. The State Council (sets up deadline for project approval)

China's Foreign Policy Dynamics with Nepal

Nepal occupies a distinctive place in Chinese foreign policy, albeit often characterised as a country of ‘peripheral’ concern by many scholars in China. Since the establishment of diplomatic relations in 1955, China has maintained a measured policy towards Nepal. While Nepal may not have been a central focus in China’s broader foreign policy, it has gained significance in China’s neighbourhood policy in recent years.

Several considerations underpin China’s policy towards Nepal. The country shares the longest border with China after India, with a substantial part of this border remaining unguarded due to challenging mountainous terrain. Joint statements from both nations have consistently emphasised the strengthening of ‘border area management’.

Geographically, Nepal has long served as the southern gateway to Tibet, fostering close economic and cultural ties since ancient times. For China, Nepal serves as a geographic and cultural buffer between Tibet and Tibetan refugees residing in India. In light of the Khampa uprising experience in the late 1950s and early 1960s, Beijing is apprehensive that Nepal could be manipulated by external powers as a frontline state to challenge China’s security interests, particularly concerning Tibetan refugees.

Addressing China’s security concerns, the Chinese ambassador to Kathmandu in May 2001, Zeng Xuyong, affirmed China’s vital interest in securing its strategic southern border by

⁶ Mark Yaolin Wang, “The Motivations Behind China’s Government-Initiated Industrial Investments Overseas”, *Pacific Affairs*, Vol. 75 (2), Summer 2002, pp.198-200.

⁷ “Does China Dominate Global Investment?”, *ChinaPower*, for other details see at <https://chinapower.csis.org/china-foreign-direct-investment/> (accessed on 25 December 2023)

cultivating a credible relationship with Nepal.⁸ Some analysts suggest that China, while not explicitly stating concerns about external forces in Nepal, harbours insecurities regarding India's leverage and the influence of the United States, the United Kingdom, and the European Union in the country.

Persistent suspicion in China revolves around the perceived misuse of the Nepal-Tibet and Nepal-India borders by Tibetan refugees. China consistently emphasises Nepal's adherence to the "one China" policy and the prevention of Tibetans engaging in any anti-China activities. Strategically, Nepal holds the third position in importance to China in South Asia, following Pakistan and Sri Lanka.

Ensuring Nepal's neutrality on the Tibet issue and preventing the possibility of India-Nepal collusion on the matter becomes paramount from the Chinese perspective. Simultaneously, China seeks a credible nationalist force and meaningful economic engagements in Nepal amenable to its influence to address security concerns.

China adjusted its Nepal policy after the anti-China protests of 2008 and political changes in Nepal during the same year. The redefined policy, as articulated by the former Chinese Ambassador to Kathmandu, Qiu Guihong, involved a fourfold approach: First, accommodating each other's political concerns. Second, enhancing economic cooperation based on mutual benefit. Third, boosting people-to-people and cultural exchanges. Fourth, strengthening coordination and cooperation in international and regional affairs.⁹

Therefore, China's policy towards Nepal differs significantly from its approach to other South Asian countries. It revolves around three major strategic interests: (i) containing Tibetan refugees in the south of the Himalayas and controlling their anti-China activities; (ii) neutralising India's influence in Nepal and establishing a pro-China regime in Kathmandu, marked by increased engagement post-monarchy and various soft diplomatic measures; and (iii) investing in strategically important infrastructure projects such as airports and highways. China's investments in Lumbini, Special Economic Zones (SEZs), hydropower, joint ventures near the Nepal-India borders, and the aviation sector reflect a comprehensive effort to enhance its leverage with the Nepalese people and government.¹⁰

Existing Investment Policies in Nepal

To foster greater FDI and bridge the funding gap between public investment and capital expenditure, Nepal undertook a significant step on 27 March 2019 by revising its Foreign Investment and Technology Transfer Act (FITTA). This amended act replaced the 1992 version, reflecting Nepal's commitment to creating an environment conducive to FDI. In addition to this pivotal amendment, Nepal has implemented various investor-friendly measures aimed at attracting more FDI and bolstering the national economy.

⁸ Zhang Li, "To manage conflict in South Asia: China's stakes, perceptions and inputs", Asia Paper, Institute for Security and Development Policy, Stockholm, October 2009, p.76.

⁹ "Nepal and China have win-win ties", interview of Chinese ambassador to Nepal, Qiu Guohong, *Nepali Times*, Kathmandu, [weekly] Issue 448, 24–30 April 2009.

¹⁰ Nihar R Nayak, "Strategic Himalayas Republican Nepal and External Powers", IDSA and Pentagon Press, New Delhi, 2014, p. 81.

The Industrial Enterprises Act of 2020, as outlined in the 2022 report from the Department of Industries (DoI), stands as one such measure. Moreover, several legal frameworks guide and encourage FDI in Nepal, including:

- a) Foreign Investment Policy, 2015
- b) Public-Private Partnership and Investment Act, 2019
- c) Institutional reforms such as the establishment of One Stop Service Centre to facilitate foreign investment, and
- d) Nepal Rastra Bank Foreign Investment and Foreign Loan Management By-law, 2021 (Second Amendment).

For the expeditious approval of projects, the DoI, under the Ministry of Industry, Commerce, and Supplies, oversees investments in Nepal up to NPRs6 billion. Beyond this threshold, the Investment Board of Nepal (IBN) assumes the authority to approve investments exceeding NPRs6 billion. In the hydropower sector, projects up to 200 MW fall under the purview of the DoI, while those exceeding this capacity are scrutinised by the IBN.

Despite the formulation of the Foreign Investment Act in 1982 and subsequent economic liberalisation in the 1990s, Nepal has experienced persistently low FDI inflow, averaging only around \$8 million per year for a certain period. The overall assessment suggests that, considering the size of the population, available resources, economic activity levels, and strategic location, FDI inflow has been modest. Historically, the bulk of FDI has been directed towards manufacturing, tourism, and small-scale sectors. India has been the primary source of FDI in Nepal since 1951, when the Nepal Commercial Corporation was established as a joint venture with 67 percent equity participation from Indian investors.¹¹

Factors such as political instability, frequent changes in the government in Kathmandu, and a decade-long Maoist insurgency have contributed to a low confidence level among investors in Nepal. Addressing this concern, former Chinese ambassador Hou Yanqi remarked in a virtual press conference organised by the Chinese embassy in Nepal on 21 April 2022, stating, “The [frequent] change in policies with the changes in the government is a cause of concern... it is challenging for Chinese investors in Nepal due to the shifting governments in Nepal and the policies taken by each government.”¹² This apprehension is not unique to Chinese investors but is shared by others as well, highlighting the need for stability and consistency in Nepal’s investment climate.

Benefits of Investment in Nepal

Nepal leverages non-reciprocal and exclusive treaties with India, entailing duty-free access for Nepali products in the Indian market. Likewise, as a Least Developed Country (LDC), Nepali

¹¹ “A Survey Report on Foreign Direct Investment in Nepal”, Nepal Rastra Bank, Research Department June 2018, p. 18. See https://www.nrb.org.np/contents/uploads/2019/12/Study_Reports-A_Survey_Report_on_Foreign_Direct_Investment_in_Nepal.pdf

¹² “Policy changes in Nepal cause for concern for investors: Chinese ambassador” *The Kathmandu Post*, 21 April 2022, [Policy changes in Nepal cause for concern for investors: Chinese ambassador \(kathmandupost.com\)](https://www.kathmandupost.com/news/Policy_changes_in_Nepal_cause_for_concern_for_investors:_Chinese_ambassador) (accessed on 26 December 2023)

products benefit from duty-free access to China, as well as to the European Union, United States, Canada, Australia, and other developed countries. This strategic positioning creates favorable conditions for investments and production in Nepal, with the potential to tap into global export opportunities. Of significant note is Nepal's geographical location, strategically situated between two of the world's largest markets.

Table-2: Country and Sector-wise FDI stock in Nepal as of Mid-July 2021

Rs. Million

| S.N | Countries | Agriculture | Industry | Services | Total | Share in Total (%) |
|-----|-----------------------|--------------|------------------|-----------------|------------------|--------------------|
| 1 | India | 22.0 | 58,966.5 | 16,825.7 | 75,814.2 | 33.3 |
| 2 | China | - | 35,985.9 | -2,984.9 | 33,001.0 | 14.5 |
| 3 | Ireland | - | - | 16,482.1 | 16,482.1 | 7.2 |
| 4 | Singapore | | 14,445.7 | 1,036.0 | 15,481.7 | 6.8 |
| 5 | Saint Kitts and Nevis | - | - | 14,513.1 | 14,513.1 | 6.4 |
| 6 | Australia | - | 613.4 | 11,532.0 | 12,163.4 | 5.3 |
| 7 | South Korea | 41.0 | 8,852.0 | 456.6 | 9,349.5 | 4.1 |
| 8 | UAE | - | 8334.7 | 15.8 | 8,350.5 | 3.7 |
| 9 | USA | 47.8 | 1,199.7 | 5,462.1 | 6,709.7 | 2.9 |
| 10 | Bangladesh | - | - | 6,383.5 | 6,383.5 | 2.8 |
| 11 | Netherlands | 85.0 | 97.3 | 5,187.7 | 5,370.0 | 2.4 |
| 12 | UK | 6.7 | 351.1 | 4,442.4 | 4,800.3 | 2.1 |
| 13 | Pakistan | - | 6.6 | 4,026.5 | 4,033.1 | 1.8 |
| 14 | British Virgin Island | - | - | 3,670.0 | 3,670.0 | 1.6 |
| 15 | Mauritius | - | 1,901.4 | 959.2 | 2,860.6 | 1.3 |
| 16 | Japan | 23.2 | 800.7 | 1,979.9 | 2,803.8 | 1.2 |
| 17 | Bermuda | - | 2,039.5 | - | 2,039.5 | 0.9 |
| 18 | Hong Kong | - | 1,333.5 | 685.1 | 2,018.6 | 0.9 |
| 19 | Norway | 5.0 | 1,433.2 | 8.6 | 1,446.8 | 0.6 |
| 20 | Sri Lanka | - | 515.1 | 662.3 | 1,177.4 | 0.5 |
| 21 | Others | 10.1 | 1,094.3 | -1,626.2 | -521.8 | -0.2 |
| | Total | 240.9 | 137,988.4 | 89,717.6 | 227,946.9 | 100.0 |

Source: Field Survey, 2022, Nepal Rastra Bank, Nepal

List of MoUs Signed with China for Investments in Nepal

1. The Confederation of Nepalese Industries (CNI) and the China Council for the Promotion of International Trade (CCPIT) solidified their commitment to set up the Nepal-China Business Council for strengthening economic ties and cooperation between Nepal and China in September 2023.¹³
2. MoU on Establishment of Investment Cooperation Working Group between the Ministry of Finance of Nepal and the Ministry of Commerce of the People's Republic of China.¹⁴
3. Damak Clean Industrial Park, a China-invested company, signed a Memorandum of Understanding with the Investment Board of Nepal for the China-Nepal Friendship Industrial Park in Nepal's eastern Jhapa district in October 2019.¹⁵
4. Nepal-China Executives Council, a non-profit organisation based in Nepal, and the Department of Commerce, Yunnan Province, Government of China, signed an agreement to work in collaboration to promote bilateral trade and investment in November 2016.¹⁶

Trends in Chinese Investment in Nepal

Table 2 underscores China's significant role as a key investor in Nepal. While China initially showed limited interest in Nepal's early economic reforms for business investments, it emerged as the second-largest investor after India from 2012 onwards. During the initial period, Chinese economic engagements with Nepal were dominated by Official Development Assistance (ODA) rather than FDI, with Chinese investments in Nepal remaining under \$1 billion from 2002 to 2012.¹⁷

The surge in China's economic activities in Nepal, particularly as an investment destination, can be attributed to changes in the geopolitical landscape of the Himalayan region and the political transformation in Nepal from monarchy to multiparty democracy in 2008. Contrary to some Western scholars attributing this shift to China's Western Development Programme (1999) and "Going Out" policy (2000), available information and Chinese investment data suggest that China did not significantly invest in Nepal from 1990 to 2012. China took

¹³“FNCCI urges Chinese banks’ presence in Nepal”, *The Kathmandu Post*, 24 September 2023, <https://kathmandupost.com/money/2023/09/24/fnci-urges-chinese-banks-presence-in-nepal> (accessed on 25 December 2023)

¹⁴ “List of Instruments Signed and Exchanged between Nepal and China”, 13 October 2019, Ministry of Foreign Affairs, Government of Nepal, <https://mofa.gov.np/list-of-instruments-singed-and-exchanged-between-nepal-and-china/> (accessed on 25 December 2023)

¹⁵ “MoU signed for China-Nepal Friendship Industrial Park in eastern Nepal”, *Xinhua*, 10 April 2019, http://www.xinhuanet.com/english/2019-10/04/c_138448286.htm (accessed on 25 December 2023)

¹⁶ “MoU signed to boost Nepal-China trade” *The Kathmandu Post*, 03 November 2016, <https://kathmandupost.com/money/2016/11/03/mou-signed-to-boost-nepal-china-trade> (accessed on 25 December 2023)

¹⁷ Avasna Pandey, “Economics and Influence: Chinese Investments in Nepal”, *South Asia Voice*, STIMSON, 12 November 2020. For details see <https://www.stimson.org/2020/economics-and-influence-chinese-investment-in-nepal/> (accessed on 25 December 2023)

approximately 12 years to become a major investor in Nepal from its “going out” policy, whereas India achieved a similar status in the 1980s. Notably, during this period, some small Chinese companies invested in Nepal’s food processing (primarily processed beef, pork, and buffalo meat) and agriculture sectors to supply processed foods to construction workers engaged in infrastructure developments in Tibet. China took interest in hydropower sector around 2010, coinciding with Nepal’s further liberalisation of the hydro energy sector for private company investments under the 1992 Electricity Act.

In the restaurant sector, only 4-5 Chinese restaurants were present in the Thamel area of Kathmandu initially. However, the number of Chinese restaurants in Thamel skyrocketed in 2012, reaching approximately 150 in 2022. It’s worth noting that Nepal was the first South Asian country accorded Approved Destination Status by China in November 2001.

Various studies and data from the IBN indicate that Chinese companies have shown interest in investing in services, hydro energy, manufacturing, apparel, and agriculture sectors in Nepal. Table 3 reflects that these sectors were identified based on the overall strategic interests of the Chinese state in the Himalayan region. Sectors like tourism were identified based on low investments and guaranteed high-profit principles, as Chinese investors anticipated a surge in Chinese tourists in the future. In 2013, Chinese tourist arrivals in Nepal crossed the 100,000 mark for the first time. Just before the COVID-19 restrictions, Nepal aimed to attract two million foreign tourists, including 350,000 Chinese visitors, under the Visit Nepal Year 2020 campaign.¹⁸

Table-3: Major Chinese FDI Stock in Nepal

Rs. Million

| Component | Paid-Up | Reserves | Loan | FDI | Share in China’s FDI |
|---|-----------------|-----------------|-----------------|-----------------|----------------------|
| Electricity, gas, steam, and air conditioning | 8,032.1 | -2,149.5 | 17,495.1 | 23,377.7 | 69.9 |
| Manufacturing | 12,801.6 | 2,111.9 | 74.9 | 14,988.4 | 44.8 |
| Information and Communication | 1,004.6 | 346.4 | 254.5 | 1,605.5 | 4.8 |
| Accommodation& Food Services | 947.2 | -4.7 | 1.2 | 943.8 | 2.8 |
| Others | 1,555.7 | -9,022.3 | - | -7,466.7 | -22.3 |
| Total | 24,341.2 | -8,718.2 | 17,825.6 | 33,448.6 | 100.0 |

Source: Field Survey, 2023, published by Nepal Rastra Bank, Nepal

¹⁸ “After Xi Jinping’s visit, Nepal is expecting a surge in Chinese tourists,” *The Kathmandu Post*, 20 October 2019, <https://kathmandupost.com/money/2019/10/20/after-xi-jinping-s-visit-nepal-is-expecting-a-surge-in-chinese-tourists> (accessed on 27 December 2023)

Top Ten Priority Sectors for Chinese Investments in Nepal

1. Services (Hotel, Restaurants, Telecommunication)
2. Manufacturing
3. Aviation
4. Slaughterhouses
5. Packaged drinking water
6. Ready-made garments
7. Electric vehicle assembly
8. Copper mining
9. Agriculture
10. Hydro energy

The available sources indicate a consistent surge in Chinese investment commitments in the Nepali market since 2012-2013, witnessing a decline in the fiscal year 2022-2023. The fiscal years 2015-2016 and 2016-2017 marked the peak of Chinese investment commitments, accounting for over 70 percent of Nepal's total FDI during that period. Officials from the DoI in Nepal noted that initially, Chinese investments were primarily focused on small restaurants but gradually diversified into hydropower and other sectors. The tourism sector received the largest share of Chinese FDI commitments, reaching US\$125 million as of July 2021, followed by other services and the information technology sector.¹⁹

Private sources indicate that over 1005 Chinese companies were operating in Nepal as of July 2016, with varying levels of investment, including large, medium, and small enterprises. On average, around 200 Chinese companies entered the Nepali market each year from 2012 to 2016. While most small companies operated with 100 percent investments from China, larger and medium-scale projects typically involved over 60 percent share from Chinese companies and the rest from Nepali partners.

Interestingly, Chinese companies showed limited interest in banking, higher education, and high-value technology-intensive manufacturing projects in Nepal, in contrast to substantial investments made in other countries. While Chinese restaurants and hotels contributed over 10,000 jobs in Nepal and revenue to the Nepali state, their impact on the technology and capital-hungry manufacturing sectors, apart from the cement industry, was relatively minimal.

Major Joint Venture Projects

In September 2017, the Investment Board of Nepal facilitated a Project Investment Agreement (PIA) for a joint venture (JV) between Hongshi Cement of China and Shivam Cement Pvt. Ltd

¹⁹ "China remains largest source of FDI for Nepal for 6 consecutive years", *Xinhua*, 21 July 2021, for details see http://www.xinhuanet.com/english/asiapacific/2021-07/21/c_1310075557.htm (accessed on 25 December 2023)

of Nepal, resulting in the construction of a 12,000 TPD cement project in Nawalparasi district. Hongshi Cement holds a 70 percent share in the project, which started trial production in May 2018, showcasing an efficient implementation process within a year of the PIA.

Following the Hongshi-Shivam Cement JV, another PIA was signed between Huaxin Cement Narayani and the IBN in Beijing in June 2018. This paved the way for the construction of the 3000 TPD Huaxin Cement Narayani Project in Dhading district, with test production beginning in January 2022. Despite successful implementation, a sub-committee formed by the Public Accounts Committee (PAC) of parliament raised concerns about the project not adhering to the terms and conditions outlined in the Environmental Impact Assessment (EIA) report. Issues related to haphazard construction of access roads affecting local irrigation canals were also noted.²⁰

In addition to manufacturing, the hydro sector has attracted Chinese FDI, as evidenced by the IBN's signing of an MoU in January 2020 for a JV with the Power Construction Corporation of China Ltd (PCCCL) and Hydroelectricity Investment and Development Company Ltd. (HIDCL) of Nepal. The MoU pertained to the development of the Tamor Storage Hydroelectric project with an indicative installed capacity of 756 MW in Terhathum and Panchthar districts. However, the project faced a three-year delay, prompting the IBN to seek an explanation from PCCCL in May 2023. Little to no significant progress has been achieved in the project since the signing of the project development agreement in December 2022.

Furthermore, in June 2021, the IBN, chaired by then Nepali Prime Minister KP Sharma Oli, approved a proposed investment of 33.41 billion Nepali rupees (\$280 million) for the development of the Lower Manang Marsyangdi Hydroelectric Project with a capacity of 139.2 MW. The project, developed under the build, own, operate, and transfer (BOOT) modality, involved a joint venture between Sichuan Provincial Investment Group Co. Ltd, Chengdu Xingcheng Investment Group Co. Ltd, Sichuan Qing Yuan Engineering Consulting Co. Ltd, and Nepal's Butwal Power Company.²¹

Himalaya Airlines, a Nepal-China joint venture in the aviation sector, was established in 2014, representing the largest FDI from China in Nepal's aviation sector.²² In the realm of Special Economic Zones (SEZs), a Memorandum of Understanding (MoU) was signed in October 2019 between Lhasa Economic and Technological Development Zone Jing-Ping Joint Creation Construction Project Development Co. Ltd (JPJCCPD) and Damak Clean Industrial Park Pvt. Ltd (DCIP) with the assistance of IBN for building the China-Nepal Friendship Industrial Park

²⁰ "Huaxin Cement Narayani flouting EIA norms: PAC sub-committee", *myRepublica*, 22 July 2019, <https://myrepublica.nagariknetwork.com/news/huaxin-cement-narayani-flouting-eia-norms-pac-sub-committee/> (accessed on 26 December 2023)

²¹ "China-Nepal joint venture gets nod to develop hydropower projects in Nepal", *Xinhua*, 24 June 2021, http://www.xinhuanet.com/english/asiapacific/2021-06/24/c_1310024203.htm#:~:text=Sichuan%20Provincial%20Investment%20Group%20Co,model%20on%20the%20Marsyangdi%20river (accessed on 27 December 2023)

²² "China-Nepal joint venture Himalaya Airlines takes delivery of Airbus", 10 March 2016, http://m.tibet.cn/eng/travel/guides/201603/t20160310_5717629.html (accessed on 27 December 2023)

in Damak, Jhapa district. However, as of the latest update, the project implementation is pending, and the completion deadline has been extended to 2024.

Perceptions and Challenges

Many Nepali elites and political leaders view Chinese investment as an alternative to India, although issues such as delays in project implementation, rising project costs, and unfinished projects have shifted Nepali perceptions of Chinese investments. Some voices in Nepal posit that China's increasing interest in specific sectors could be part of its geopolitical strategy. However, there are diverse opinions within Nepal, with some left-leaning bureaucrats and media houses emphasising the importance of considering Chinese investment not only from a geopolitical perspective but also as an opportunity. Despite historical challenges with project delivery, this perspective acknowledges the potential influence of Chinese investments in Nepal.

Patterns of Chinese Investments in Nepal

In this context, it is worth investigating the motives behind Chinese investments in Nepal. Examining the objectives of China's "Go Global" policy and its investment trends in other countries, several factors shape Chinese investment in Nepal. First, Nepal, despite its strategic importance, is not a large market for Chinese goods. Second, aside from water resources, Nepal lacks significant raw materials essential for Chinese industries. Third, Nepal's frequent political instability has impacted its FDI policy, exacerbated by the absence of a single-window system for project approval until 2022. The early 2000s saw a withdrawal of many Indian investors citing a hostile investment atmosphere, contributing to the challenges faced by Nepal. Fourth, being a landlocked country, exporting finished products from Chinese-invested Nepali units involves a cumbersome process. Finally, given Nepal's status as a Least Developed Country, there were limited possibilities for China to acquire modern technological information.

If market, resources, trade and technology are not the primary motivating factors for Chinese investments in Nepal, then the major incentive could be the strategic information gained through economic engagements in the sub-Himalayan region. Analysis of Chinese investment patterns in Nepal indicates that Chinese companies, both private and State-Owned Enterprises, have made more commitments than actualising them into projects.

More Commitments and Less Execution

A significant gap exists between Chinese committed investment and its actual realisation. For instance, during the 2017 investment summit, Nepal received the largest investment pledges from Chinese investors. Of the total pledged investment of US\$13.52 billion, \$8.2 billion came from Chinese investors, representing 61 percent of total investment pledges.²³ No detail information are available how many projects were implemented as per the pledges.

²³ "China tops participation in upcoming Nepal Investment Summit" *Xinhua*, 22 March 2019, http://www.xinhuanet.com/english/2019-03/22/c_137915950.htm (accessed on 25 December 2023)

In 2019, despite China declaring the largest number of participants in the investment summit, the investment pledges were comparatively minuscule compared to the 2017 summit. During the 2019 summit, a Joint Development Agreement was signed for the 164MW Kali Gandaki Gorge Project, but the construction is yet to commence.²⁴

Ten months after (January 2020) showcasing 50 infrastructure projects at the Investment Summit and after one deadline extension for prospective investors to submit the proposals, the IBN has finally completed the prequalification of companies that are vying to bag 14 such projects from the list of 50 showcased projects. The board selected a joint venture of Hydroelectricity Investment and Development Company and Power China to carry out detailed feasibility studies of the 756-megawatt Tamor Storage Hydroelectric Project and has signed a Memorandum of Understandings with two companies for a detailed study of NPRs13 billion multimodal logistics park at industrial towns and trade transit points of Biratnagar, Birgunj and Bhairahawa.²⁵

Nepal did not hold any investment summit during COVID-19 restrictions. It held two separate summits— an infrastructure summit and an investment summit in 2022. Interestingly, Chinese companies did not participate in either format. Most notably, Chinese investments in Nepal further declined in 2022.²⁶

This trend repeated in 2023, with Chinese companies showing little interest in participating in the Power Summit held on April 18-19, 2023, in Kathmandu.²⁷

Despite the gap in investment pledges and materialisation, Chinese companies claim significant contributions to the improvement of local electricity supply following the operation of the Upper Marsyangdi-A hydropower station in Nepal in September 2016 and the Upper Tamakoshi Hydroelectric Project in March 2022.²⁸

On the contrary, the DoI observed an 89 percent year-on-year increase in FDI pledges (all sources) to Nepal during the first four months of the fiscal year 2023-2024. However, the gap between FDI commitments and realisation remains substantial, with FDI contributing only 0.1

²⁴ “Investment Summit ends on a high note with signing of 15 deals” *The Kathmandu Post*, 31 March 2019, <https://kathmandupost.com/national/2019/03/31/investment-summit-ends-on-a-high-note-with-signing-of-15-deals> (accessed on 25 December 2023)

²⁵ “Nepal secures nearly \$12 billion from Investment Summit 2019” *The Kathmandu Post*, 03 January 2020, <https://kathmandupost.com/money/2020/01/03/nepal-secures-nearly-12-billion-from-investment-summit-2019> (accessed on 25 December 2023)

²⁶ “Two-day ‘Nepal Investment Conference 2022’ concludes successfully,” *myRepublica*, 12 April 2022, <https://myrepublica.nagariknetwork.com/news/two-day-nepal-investment-conference-2022-concludes-successfully/> (accessed on 25 December 2023)

²⁷ “Chinese companies showing little interest in power summit” *The Kathmandu Post*, 10 April 2023, <https://kathmandupost.com/national/2023/04/10/chinese-companies-showing-little-interest-in-power-summit> (accessed on 25 December 2023)

²⁸ “Can India's attempts to squeeze Chinese investment in Nepal's energy sector succeed?” *Global Times*, 10 June 2023, <https://www.globaltimes.cn/page/202306/1292320.shtml> (accessed on 25 December 2023)

percent to the GDP according to the World Bank's Nepal Development Update in October 2023.²⁹

SOE Dominated Investments

Chinese investments primarily comes from two categories—state-owned or private. State-owned enterprises are significantly involved in critical infrastructure projects such as hydropower and road construction, mainly in sectors viewed as strategically important.³⁰

Investments from private Chinese companies, on the other hand, are mainly in micro-enterprises, particularly in potentially profitable sectors like services, tourism, manufacturing, and apparel. Some private companies withdrew after showing initial interest due to project inviability, while many smaller private companies continue their operations illicitly, taking advantage of poor investment governance mechanisms in Nepal.

Another observed pattern is that more SOEs with less than US\$1 million have invested in Nepal than large private companies. In comparison to India's investments in Nepal, Chinese companies have predominantly invested in the restaurant, hotel, and apparel sectors, primarily targeting the growing number of Chinese tourists in Nepal. Transactions of these restaurants via Chinese digital wallets Alipay and WeChat, until May 2019, resulted in Nepal losing foreign currency as the actual transactions took place in China.³¹ Additionally, illegal Chinese companies exploit Nepali territory for offshore business due to inadequate monitoring mechanisms.³²

Fraudulent Chinese Private Companies and Policy Adjustments

Since 2016, fraudulent operations of Chinese private companies abroad have been a major concern and a global reputation issue for China. China's "going out" strategy, declared in 2000, removed restrictions on overseas investments. However, after a record \$216 billion of outward foreign investment in 2016, the Chinese government adjusted its policy. In December 2017, guidelines were issued, including the Code of Conduct for Overseas Investment by Private Enterprises and Administrative Measures for Overseas Investments by Enterprises, aiming to check irrational or fraudulent private enterprise investments.³³

²⁹ "Foreign investment pledges up 89 percent" *The Kathmandu Post*, 30 November 2023, <https://kathmandupost.com/money/2023/11/30/foreign-investment-pledges-up-89-percent> (accessed on 25 December 2023)

³⁰ Avasna Pandey, "Economics and Influence: Chinese Investments in Nepal", *South Asia Voice*, STIMSON, 12 November 2020. For details see <https://www.stimson.org/2020/economics-and-influence-chinese-investment-in-nepal/> (accessed on 25 December 2023)

³¹ "Nepal bans Chinese digital wallets", *Business Standard*, 21 May 2019, https://www.business-standard.com/article/pti-stories/nepal-bans-chinese-digital-wallets-119052101425_1.html (accessed on 25 December 2023)

³² In 2019, some 94 Chinese nationals were arrested on grounds of public offenses, banking fraud, and black marketing. In 2020, 29 Chinese were taken into custody for online gambling, public offense, kidnapping and bank fraud. In 2021 again, 18 Chinese were arrested for similar criminal. <https://www.wionews.com/south-asia/increasing-illegal-activities-by-chinese-serious-concern-for-nepal-509581> (accessed on 25 December 2023)

³³ Perry Wong, et.al, Milken Institute, "China's Global Investment Strategy, pp. 19-21.

Backing Off and Strategic Investments

Instances exist where Chinese companies backed off due to financial non-viability, such as the West Seti Hydroelectric project. The USD \$1.2 billion project, intended to be developed by China's state-owned Three Gorges International, was formally terminated in 2018 due to an inability to work out the financial modality. Similarly, in 2017, the government terminated an agreement with Gezhouba Group for the development of the Budhigandaki Hydropower Project (US\$44.6 million).³⁴

Lastly, a significant number of Chinese investments facilitated through SOEs exhibit more strategic underpinnings compared to those by private companies. SOEs predominantly focus on the Terai region, sharing a border with India. Notably, the Sino-Nepal SEZ in Chitwan is a joint venture (JV) between the Nepali government and the Chinese Company, China Communication Construction Company (CCCC), established in 2019. Similarly, the Damak Clean Industrial Park in Jhapa district is a JV between the Nepali government and the Lhasa Economic and Technological Development Zone Investment Development Company Limited, with an agreement signed in October 2019. Furthermore, the Hongshi – China and Shivam Cement Pvt. Ltd are also located in the Terai region. In 2019, two Chinese airport construction firms submitted proposals for the US\$3.45 billion Nijgadh International Airport in Bara district. Additionally, in 2011, the Asia Pacific Exchange and Co-operation Foundation (APECF), a Chinese-government-backed organisation based in Hong Kong, planned a US\$3 billion investment in Lumbini.

Beyond geopolitical considerations, it is noteworthy that a majority of Chinese investment pledges and agreements were inked either under the left party unity government or again under a government led by the CPN-UML. China identified the CPN-UML as a reliable political partner in the post-monarchy period, attributed to ideological alignment, a favorable business environment, and nationalist factors. During the CPN-UML regime in 2018, China emerged as the largest investor in Nepal, constituting 86.66 percent of the total FDI commitments received by Nepal. This trend persisted in 2019.³⁵ Notably, the Jhapa SEZ was established in the political constituency of former Prime Minister K P Sharma Oli, serving as a form of political protection against noncompliance with investment norms.

Policy Recommendations:

1. **Diversify Economic Sectors:** Nepal should strive for a balanced approach, promoting not only the services sector, particularly restaurants and hotels dominated by Chinese investments but also focusing on the manufacturing sector. Encouraging investors to explore projects beyond Kathmandu and Pokhara will contribute to the economic development of other regions. While the services sector provides jobs and revenue,

³⁴ Avasna Pandey, "Economics and Influence: Chinese Investments in Nepal", *South Asia Voice*, STIMSON, 12 November 2020. For details see <https://www.stimson.org/2020/economics-and-influence-chinese-investment-in-nepal/> (accessed on 25 December 2023)

³⁵ "China contributes over 80 pct of FDI pledges to Nepal", Xinhua, 22 June 2018. For details see [China contributes over 80 pct of FDI pledges to Nepal china.org.cn](http://china.org.cn) (accessed on 26 December 2023)

prioritising manufacturing will address capital and technological deficits, creating more employment opportunities and reducing dependence on external sources.

2. **Strengthen Institutional Framework:** To instill confidence in investors and mitigate concerns arising from frequent policy changes, Nepal must establish robust, apolitical democratic institutions and bureaucracy. Implementing clear and stable statutory investment policies will create a favourable environment for foreign investors, fostering a sense of security and stability.
3. **Capacity Building and Technological Empowerment:** Enhancing the capabilities of various monitoring agencies in Nepal is essential. This involves providing training and capacity-building programs to ensure they stay updated on the latest policies and possess the technological tools needed to monitor and regulate investments effectively. The focus should extend to curbing illegal and fraudulent activities, including investments, call centers, and payment apps operating in Nepal. By adopting modern monitoring mechanisms, the government can safeguard against illicit practices, ensuring transparency and adherence to regulations.

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