Asia-Pacific Research and Training Network on Trade
Working Paper Series, No. 22, November 2006

Foreign investment liberalization and incentives in selected Asia-Pacific Developing Countries: Implications for the health service sector in Nepal

By

Nephil Matangi Maskay, Rajan Krishna Panta and Bishnu Prasad Sharma*

*Nephil Marangi Maskay, Rajan Krishna Panta and Bishnu Prasad Sharma are Lectures at Tribhuvan University. The views presented in this paper are those of the authors and do not necessarily reflect the views of ARTNeT members, partners and the United Nations. This study was conducted as part of the Asia-Pacific Research and Training Network on Trade (ARTNeT) initiative, aimed at building regional trade policy and facilitation research capacity in developing countries. This work was carried out with the aid of a grant from the International Development Research Centre, Ottawa, Canada. The technical support of the United Nations Economic and Social Commission for Asia and the Pacific is gratefully acknowledged. Any remaining errors are the responsibility of the authors. The authors may be contacted at nmmaskay@mos.com,np, panta_rajan@yahoo.com

Executive Summary

To take full advantage of the opportunity provided by integration with the global economy – reflected partly by membership in the World Trade Organization (WTO) - it is essential that developing countries have built-up appropriate supply capacity to ably meet with the standards of consumers and governments in other countries; this point is especially true in the leading sector of growth for developing economies – the services sector. For attaining the aforementioned goal of strengthening the domestic service industry, it is necessary for attracting foreign investors since their input is felt to provide necessary quality and methods, to ensure that domestic service products are internationally competitive. This can be seen in most countries having given preference to liberalization of foreign direct investment (FDI) in the service sector through commercial presence. A problem, however, is that utilizing the experiences of developed countries to optimize this strategy for attracting investment in the service sector in developing countries, may not be appropriate and practicable. The paper focuses on attracting FDI in the health services, in large part due to its importance to a country's overall development. Further, the paper endeavors to utilize the lessons from successful developing countries for attracting FDI in the service sector (in particular health) for the Kingdom of Nepal, a least developed country (LDC) located in south Asia.

The prime objective and main research questions of the study are: 1) What are the practices of service sector investment liberalization and incentives from selected developing countries, and 2) How those experiences can be applied to the investment liberalization and provision of incentives in the Nepalese services sector, with focus on the health service sector? It should be pointed out that a country's liberalizing strategy refers to a dynamic policy process through a flow in time; however since this study is presently limited to focus on a point in time (e.g. 2003), attention is given to FDI incentives in selected developing countries to tease out lessons of a broad service related investment (health) liberalization strategy.

The study initially reviews literature on FDI attractors and makes a distinction between determining factors and incentives. The prior are factors being more difficult to change (such as size and population of the economy), while the later are less rigid and can influence the direction of the determining factors. In this regard, the four major determinants of FDI are: quality of infrastructure; level of skill and human capital; regulatory environment; and incentives (facilitating mechanism [procedure etc.], infrastructure incentive, regulation incentives and fiscal and financial incentive). The review focuses on the services sector and concludes that there is no consensus among the analysts on the role of various determinants and incentives. Literature relating to FDI in health is also reviewed where an important issue is the degree of commercialization of health services to benefit from FDI in health.

The study focuses on the experiences of liberalization strategies and incentives for attracting investment in (health) services of selected developing countries – Bangladesh, India, Malaysia, People's Republic of China, Singapore, Sri Lanka and Thailand. The study finds that despite these countries being quite varied (e.g. economic size, area,

population), the incentives are similar in both their non-specific nature to services as well as the general ranges of incentives offered, although variable in regulatory incentive. It was observed for the countries examined that there did not appear to be a clear relationship between the incentives (e.g. liberalization strategy) and FDI flows; the exception is the regulatory incentive which perhaps gives an indication of the investment climate – this has a strong relation with FDI flows.

Further, of the seven above mentioned countries, only three – India, Malaysia and Singapore – have made limited multilateral commitment in the health sector – confirming reluctance of countries to open this sector to international competition. Again, this reluctance may be due to countries not being confident enough of the control they can have in this sector (through appropriate regulation, supervision and monitoring) despite having acknowledged the importance of investing in health. This suggests a need for case studies to examine countries with both successful experiences and accessible information – this may be on developed countries whose information can be interpreted for country situation.

Based on those experiences, the study provides a road map for the future liberalization - investment in general and health services in particular - in Nepal. The study finds that the country does have a facilitating mechanism however there is presently confusion since there exists more than one, without clearly defined authorities. Further, gaps have been highlighted in the above mentioned broad incentive in comparison to those found from the examined developing countries. A roadmap of an investment liberalization strategy, is produced which tries to bridge those incentive gaps with particular attention being paid to appropriate regulation of health investment. Finally, three points are interjected for implementing this roadmap given the present condition in Nepal. These are: timing, sequence, and pace.

It should be noted that all these incentives reflect investment liberalization which try to make a hospitable environment for FDI. However political and economic stability may still be the crucial factor in determining the level of FDI – both in general and with regard to service and in particular health. An important area for the future research is what constitutes an effective package of reforms regarding the regulations of the services according to the country specific situation. In other words, it is observed that emphasis seems to be on the determinant of the investment climate.

It therefore concludes that for Nepal to capture the benefit of investment liberalization, it must continue enhancing the existing facilitating mechanism, the determinants of FDI along with the incentives in the services sector. Ensuring a stable domestic environment will be much more important to win confidence among investors. In other words, despite the roadmap for Nepal, it is felt that a more “difficult” road lies ahead for the country in attracting investment in general and specific to services (health).

Table of Contents

APPENDICES

1. Introduction:

To take full advantage of the opportunities provided by integration into the global economy – reflected partly by membership in the World Trade Organization (WTO) - it is essential that developing countries have built-up appropriate supply capacity to ably meet with the standards of consumers and governments in other countries. This point is especially true in arguably the leading sector of growth for developing economies – the services sector. For attaining the aforementioned goal of strengthening the domestic service industry, it is necessary for attracting foreign investments since their input is felt to provide necessary quality and methods and to ensure that domestic service products are internationally competitive. This can be seen in most countries having given preference to liberalization of foreign investments in the service sector through commercial presence.[1] A problem, however, is that utilizing the experiences of developed countries to optimize this strategy for attracting investment in the service sector in developing countries, may not be appropriate and practicable. The research study addresses this shortcoming by providing a critical review on the practices of selected developing countries in regard to liberalization of investment in the service sector and focuses on the health sector in particular. The selection of this sector is largely due to the importance of this sector, especially to a developing country who can benefit from several new forms of health services delivery that have emerged during the last decade. These new delivery forms result from increased ability to pay for health services arising from rising income levels, integration of information technology with health care services, movement of people seeking health care made possible by declining transportation cost and duration of travel, institutional developments in health financing and economic reform in the health care services sector (Chanda, 2001). In other words, it is felt that development of health services are both means and ends of a country's overall development.

Further and to add to the policy relevance of the analysis, the aforementioned generalized study is distilled to provide lessons to the Kingdom of Nepal, the first least developed country (LDCs), to have acceded to the WTO via the full membership process and having become the 147th member of the WTO. This analysis is focused on the health service sector of WTO's General Agreement of Trade in Services (GATS)[2], due to its importance for the Kingdom's economic growth and development (Adhikari, Maskay and Sharma, 2004). Under the language of GATS, there are four ways to provide health services,[3] however the study focuses on delivery through "commercial presence" and mostly by means of FDI flows. The specific problem is thus to provide to country specific suggestions for crafting an appropriate and attractive incentive package for

---

[1] For example, this is noted by WTO in their 2002 handbook when it is stated: "Another key policy area that comes under the spotlight in services liberalization is the treatment of foreign direct investment (FDI). Commercial presence is a key mode of supply for services, and developing countries have historically places significant restrictions on FDI in order to encourage domestic ownership of capital, limit repatriation of profits, and increase the linkages of the multinational firm with upstream suppliers".

[2] For description, see appendix 1.

[3] For description, see appendix 2.

attracting foreign investment in the domestic service sector, with focus on the domestic health service sector.

The prime objective and main research questions of the study are: 1) What are the practices of service sector investment liberalization from selected developing countries, and 2) How those experiences can be applied to the investment liberalization in the Nepalese services sector, with focus on the health service sector? It is important to point out that a country's liberalizing strategy refers to a dynamic policy process, but this study limits its focus to the selected one point in time (i.e.. 2003). This focus is given to FDI incentives in selected developing countries to tease out lessons of a broad service related investment (health) liberalization strategy. With this in mind, it is expected that the research outcome will be of policy significance for developing countries in general and provide necessary information appropriate to Nepalese policy makers in particular, to facilitate drawing foreign investment in the service sectors with focus on the health sector.

In view of the above objectives, the research paper proceeds in three parts moving from general discussion on investment incentives to narrowed down exploration of investment incentives in health services: in the first part, the theoretical and empirical studies are reviewed for preliminary identification and differentiation of determinants and incentives for attracting FDI and construction of a basic[4] investment-incentive matrix. The second part of the report critically analyzes the best practices of selected developing countries.[5] The experiences and the components of successful service sector investment liberalization will be delineated mainly at the multilateral level, which includes the various generalized incentives mentioned above to attract FDI in services. Additionally, the identified sample of countries will be further focused to those countries which have committed to multilateral liberalization in the health related service sector and what were their policies (i.e. best practices) used to mitigate negative repercussion. Further, the review will cross reference the above developed basic investment-incentive matrix, and produce a refined investment-incentive matrix for the services (health) sector in developing countries. In the third part the above analysis is applied - with refined investment-incentive matrix - to Nepal. For this purpose, a brief background is provided of both the service sector of Nepal along with the country's GATS commitments, with a description of the market for the health services. In sum, this exercise attempts to provide foundation for a feasible liberalization road map for attracting foreign investment in the Nepalese service sector with focus on the health services.

The major limitations of the study are highlighted at the end. Service sector liberalization is a very broad and emerging topic. The different types of service sectors and regulations of different countries make the policy-relevant generalizations difficult. As argued by Mattoo and Sauve, "…one of the most important and difficult issue in

---

[4] Not limited to financial and fiscal incentives but more encompassing.

[5] It is felt that at this stage the analysis can be limited to liberalization of service sector investment in the developing countries of East Asia – e.g. People's Republic of China, Malaysia, Singapore and Thailand - and South Asia – e.g. Bangladesh, India and Sri Lanka -, as the highlighted countries have arguably had a successful experience in trade (goods and services) liberalization and cover both a great majority of the population and land mass of the Asia-Pacific region.

international trade today is the relationship between trade and investment liberalization and domestic regulatory autonomy" (World Bank, 2003). The study therefore, has attempted to broadly identify some of the important issues in attracting the FDI in services and health services in particular without going into details about each piece of legislation and regulatory regimes in those countries.

2. Literature Review of FDI with Focus on Health Sector Services

2.1 Brief overview of the FDI determinants literature

The research project is taken in context of investment liberalization strategy in general with a focus on (health) service investment liberalization. The current literature on FDI mostly focuses on the determinants of FDI. For example, Nunnencamp (2002) has identified six ‘traditional determinants’ of FDI viz.1) population of host countries 2) GDP per capita of host countries 3) GDP growth of host countries 4) administrative bottlenecks 5) entry restrictions and 6) risk factors. Analyzing the data for 28 developing countries, the report concludes that traditional market related determinants are still dominant factors in shaping the distribution of FDI; non traditional factors such as cost factors, complementary factors of production and openness to trade except the availability of local skills have not gained significance.

Blonigen (2005) has done a literature review of the empirical estimation of the FDI determinants. The paper surveys the literature that empirically examines the FDI decisions of the Multi National Enterprises (MNEs) and the resulting aggregate location of FDI across the world. The paper finds that the empirical literature is still at infancy; applying the partial equilibrium approach of a MNE’s decision and analyzing the impact of exogenous factor such as taxes, exchange rates etc. on firm-level decisions. Recent literature using general equilibrium approach have not been able to capture the interconnectedness of FDI behavior with trade flows and the underlying motivation for MNEs behavior. Consequently, the paper argues that the broad generalization - such as taxes generally discourage FDI - should not be expected.

Donges (2005) has identified the following factors as the major traditional determinant of FDI viz. market size, trade related factors such as openness, wage rates, human capital, political stability, infrastructure, policy variables including the general economic fundamentals. He notes that the role and importance of these determinants are changing due to globalization, which has not received adequate attention in the literature.

The more recent literature on the determinants of FDI generally focus more on the ‘investment climate’ as broad set of regulatory and policy environment to attract FDI. The investment climate reflects the many location-specific factors that shape the opportunities and incentives for firms to invest productively, create jobs, and expand. A good investment climate is not just about generating profits for firms. A good investment climate improves the outcomes for the society as a whole (WDR, 2005). A good investment climate constitutes the requisite infrastructure facilities, sound regulatory environment and incentives to attract the FDI.

However, with the advent of globalization and the development of science and technology, the importance of incentives has received greater attention and there is a resurgence of interest in investment incentives in recent years as a determinant of FDI (Donges, 2005). Incentives are any measurable economic advantage afforded to specific enterprises or categories of enterprises by (or at the direction) a government, in order to encourage them to behave in a certain manner. They include measures either to increase the rate or return of a particular FDI undertaking, or to reduce (or redistribute) its costs or risks (UNCTAD, 1998).

In other words, the paper differentiates between the attractors of FDI into two main categories: determinants and incentives. The determinants are factors being more difficult to change (such as size and population of the economy), while incentives are less so. The three major determinants of FDI are: 1) quality of infrastructure; 2) level of skill and human capital; and 3) regulatory environment. There are several types of incentives (infrastructure incentive, regulation incentives and fiscal and financial incentive) which collectively or individually play a role in determining FDI flows. The paper focuses on each one in turn. It addresses those incentives which have apparently assumed greater significance in the context of globalization as firms have shifted away from efficiency-seeking investment to more cost-reducing investments. Moreover, these determinants are directly subject to improvement in the short run in contrast to other determinants such as the market size.

2.1.1 Quality of Infrastructure

Infrastructure provisions are an important ingredient for attracting FDI. For example, Kumar (2001) examines 66 countries and finds that quality infrastructure plays a key role in attracting FDI. One of the important factors is the quality of hard infrastructure such as roads, power, communication etc and the soft infrastructure such as efficient bureaucracy and custom administration etc. The phenomenal success of China in attracting FDI compared to other south Asian and Latin American countries are also partly attributed to the infrastructure quality. Developing countries often lack the necessary infrastructure and cumbersome bureaucracy which are the major impediments to attract the FDI. A sound investment climate - as reflected in low customs clearance times, reliable infrastructure, and good financial services - attracts foreign investment. Numerous studies have shown that cities with poor infrastructure have relatively little foreign investment and export activity (see for example, Dollar et al., 2004). Thus, the major challenge in developing countries is to devise a strategy to provide adequate infrastructure in the context of geographic location and national policies.

2.1.2 Level of skill and human capital

The people are the real asset of a nation and an essential magnet for FDI. Due to the increasing roles of services in production and distribution. The level of skills is becoming an important pull factor. Human capital formation is also one of the prerequisites to attract FDI. This is especially pronounced in the area of drawing FDI in the service sectors which are more skill oriented. Human resource development (HRD) and FDI are among the key drivers of growth in developed and developing countries. While HRD and FDI individually affect growth, they also reinforce each other through complementary effects. In general, enhanced HRD increases incoming FDI by making the investment climate attractive for foreign investors (OECD Development Centre, 2003). Thus, the HRD policy should be formulated with the aim of raising overall educational attainment while creating pockets of expertise so as to attract the type of investments that the developing countries seek. Here, multinational enterprises (MNEs) can contribute to the development of HRD by providing the training and supporting formal education as well as contribute to technology transfers through positive spillover effects. The government policies should be geared towards facilitating the investment in the HRD through basic schooling, investments in research and development (R&D) and promoting the MNEs to invest in the HRD.

2.1.3 Regulatory Environment

The regulatory environment that a host country creates plays a crucial role to attract FDI. The investment friendly regulatory legislation offers a predictable and transparent environment which has an important bearing on the competitiveness of a host country to attract FDI. This is especially important in areas like labor laws, property and market access rules and environmental protection. The recent Doing Business Report Series (World Bank, 2004, 2005, and 2006) of the World Bank investigates the regulations that enhance business activity and those that constrain it including indicators such as starting a business, hiring and firing workers, enforcing contracts, getting credit and closing business.

The role of regulation is also emphasized through international governing arrangements such as membership in: WTO; International Monetary Fund (IMF); Bilateral Investment Treaties; and Regional Arrangements on Investment etc. to provide a degree of legal certainty, predictability and protection against the arbitrary action. For example, most WTO and other agreements limit or prohibit incentive in the form of subsidies which are mentioned on the Agreement on Trade Related Investment Measure (TRIMs), Agreement on Subsidies and Countervailing Measures (ASCM) and GATS.

2.2 Role of Incentives

With globalization, the role of the traditional determinants is being reassessed. This is partly due to the reduced importance of market size and other traditional determinants of FDI as consequence of the internationalization of value-adding activities which draw the attention on fiscal and financial incentives as a determinant to attract FDI in developing countries (Donges, 2005, p.2). Moreover, since the traditional determinants of FDI such as regulatory and policy regimes, market size, economic and political stability, transparency etc are more difficult to change within a short period of time, the role of incentives are being emphasized in the recent literature (see Donges, 2005; Kokko, 2002). To quote Kokko, many instruments formerly used as development tool to promote welfare and employment e.g. trade protection or exchange rate policies were abolished. Thus, countries now put an emphasis on the remaining instruments such as investment incentives (Kokko, 2002, p6). The result of this is the growing number of incentives put forward by different countries. This is not to deny that regulation and policy framework, macro-economic stability, political stability, size of the markets etc are important determinants of FDI and any meaningful analysis of the determinants of FDI should not ignore the broader scenario and as such this study emphasizes a broader definition of incentives including the regulatory regime, infrastructure and the level of skills in the country.

2.2.1 Facilitating mechanism

Investment promotion also plays a role in attracting FDI. Investment promotion is defined to include only certain marketing activities through which governments try to attract FDI (for examples of countries in South Asia see Pant and Sigdel, 2004). Investment promotion includes the following type of activities: advertising, direct mailing, investment seminars, participation in trade shows, conducting feasibility studies, providing services to the investors after projects have become operational etc. (Wells et al, 2000)[6].

2.2.2 Infrastructure Incentives

Countries can provide additional infrastructural facilities for FDI projects in the form of incentives. In other words, infrastructure incentives include: subsidized service fees (electricity, water, telecommunications, transportation, etc.); subsidized designated infrastructure (e.g., commercial buildings); better facilities in Bonded Warehouse, Export Processing Zones (EPZs), industrial zones etc.; preferential access to government contracts; closure of the market to further entry or granting of monopoly rights; other investment facilities (JBICI, 2002).

2.2.3 Regulatory Incentives

Similarly, the role of regulation as an incentive has received attention only recently. 'Regulatory incentives' are taken to be those administrative conditions offered by governments to foreign firms other than special fiscal (e.g. tax) or financial (e.g. subsidies) treatment (FitzGerald, 2002). Financial incentives include all kind of grants, wage subsidies, reduction of the social security contribution, donations of land or site facilities, and rebates on the cost of electricity and water as well as government provision or subsidization of ‘dedicated’ infrastructure (Banga 2003, p. 17). In contrast to most fiscal and financial incentives they are granted upfront.

2.2.4 Fiscal and Financial Incentives

These incentives may be described as any tax provision granted to a qualified investment project that represents “a favorable deviation from the provisions applicable to investment projects in general.” Tax incentives can be broadly separated into several major categories: 1) reduced corporate income tax; 2) tax holidays; 3) investment allowances and tax credits; 4) accelerated depreciation; 5) exemptions from indirect taxes such as import tariffs on inputs; and 6) export processing zones (Fletcher, 2002). Further

---

[6] The role of a promotion agency in attracting FDI has been highlighted by Morisset (2003). Based on a survey of 58 countries he shows that greater investment promotion is associated with higher cross-country FDI flows, on top of the influence of the country's investment climate and market size and argues that agencies devoting more resources on policy advocacy are more effective in contrast to investment generation or targeting strategies.

Japan Bank for International Cooperation (JBICI), 2002 has also included: reduction in social security contributions; accelerated depreciation allowances and reduced taxes for expatriates as additional fiscal incentives.

Fletcher (2002) has summarized the relative advantages and disadvantages of each of the tax incentives based on the case studies of Cambodia, Lao PDR and Vietnam. He argues that tax holidays are the least preferred incentive as they are not transparent, create multiple distortions and are susceptible to abuse and tax avoidance strategies, whereas accelerated depreciation are the most desirable incentive as it is relatively transparent, is less susceptible to abuse and results in fewer distortions.

It should be pointed out that many developing as well as developed countries have used fiscal or tax incentives to attract FDI. However, there are certain differences between developed and developing countries in the composition of fiscal incentives which are reflected in both the type of FDI flows and in the geographic origin of inward FDI (Goodspeed, 2004). Table 1. lists some of the incentives used in 71 developing versus 20 OECD countries. For example, lower tax rates for FDI are used by 45% of the developing countries while OECD countries only use 5%.

Table 1. Types of FDI incentives in OECD and developing countries

FDI Incentive	**% OECD countries**	**% Developing Countries**
Capital goods import duties exempted	5	56
Tax exemption/holiday	20	55
Investment/reinvestment allowance	30	49
Lower tax rate	5	45
VAT exemption for capital goods	0	34
Accelerated depreciation	30	30
Raw material import duties exempted	5	30
VAT exemption for raw materials	5	24
Duty drawback	5	24
Export income treated preferentially	0	20
Loss write-off	0	18
Reduction in local, municipal taxes/duties	30	18
VAT exemption on exported inputs	10	18
Subsidized loans	45	18

Source: Goodspeed, 2004.

In addition to the tax incentives, there are also financial incentives. While those are less utilized in developing countries, those incentives can take the form of: investment grants; subsidized credits; and credit guarantees (JBICI, 2002). Likewise, Görg (2002) finds that more than fiscal incentives, exit costs (e.g. hiring and firing policies) are also important. This conclusion was reached based on an econometric analysis of American investments in 33 countries.

Various studies have assessed the feasibility and the effectiveness of tax incentives to attract the FDI relative to the cost. These costs are in terms of revenue loss, the generation of relatively little new investment per dollar of revenue cost and requiring increase in other distortionary taxes which can be difficult to administer; these are prone to corruption and may lead to the transfer of resources from the host country to the home country etc (Gugl and Zodrow, 2004). There have been numerous studies which point to absence of consensus over the effectiveness of the different fiscal incentives for attracting FDI and it is an empirical issue to determine the effects of such measures on the level of investment.

There is a wide range of literature discussing the impact of FDI incentives in attracting FDI. A slightly dated publication by UNCTC (1992) and UNCTAD (1996) provide an empirical estimation of the determinants of the FDI. Two category of literature can be distinguished in attracting FDI: the first one concerning the factors conducive to the Transnational Corporations (TNCs) which prompt them to invest in FDI rather than through exports and the second, host country's characteristics that attract FDI. Thus, a country which offers benefits the TNCs are looking for, get a better chance of attracting FDI. However, other micro level considerations such as the market size, level of competition with existing firms, availability of cheap labour etc in the context of the overall strategy of the TNCs exert a greater influence than the incentives alone. Once a broad selection of the region or area for the investment is done, however, the role of the incentives then becomes important.

2.3 Service Investment Liberalization

The above review has focused on the determinants of FDI and incentives in general. However, there is no consensus between the role of various determinants and incentives of FDI. The World Investment Report 2004 presents the latest trends in foreign direct investment and explores the shift towards services, with a special analysis of off shoring activities. It deals with FDI in services – which are an important but often neglected area of FDI in the context of developing countries. It examines the shift of FDI towards new service areas with a focus on the Transnational Corporations (TNCs). To benefit from an increasingly globalized and interdependent world economy, countries need to strengthen their capabilities for the supply of competitive services. If conditions are right, FDI can help to achieve this. At the same time, caution is necessary when attracting FDI in services. For instance, some services may be natural monopolies and hence susceptible to abuses of market power whereas others are of considerable social and cultural significance. Thus, in light of the shift towards services, it is felt that developing countries face a double challenge: to create the necessary conditions - domestic and international – to attract services FDI and, concurrently, to minimize its potential negative effects (UNCTAD, 2004). It is thus important to remember that while the general principles for promoting services FDI are similar to those in merchandise, some services related FDI are relatively new thus their promotion necessitates learning (such as their particular characteristics, corporate strategies, intellectual property implications, value chain organization and market leaders) to be made effective. Moreover, while it may be relatively easy to identify the target companies in service industries, targeting service functions that can be off-shored by firms from all sectors is a real challenge (UNCTAD, 2004 p195).

2.4 FDI in Health Services

Trade in health services takes many forms, including movement of health professionals, movement of consumers, foreign direct investment in health services, and electronic delivery (Chanda, 2001). However, focus is given to commercial presence through FDI in health services.[7] A significant aspect of this is trade in health services, a result of the rise of transnational corporations, challenges in health care financing, porous borders and improved technology have created the scope for increased FDI in health care. This has gathered momentum with the GATS, which aims to further liberalize trade in services, with FDI being noted as perhaps the most critical area for trade negotiations. It is argued that, on the one hand, FDI can make new services available, contribute to driving up quality and create employment opportunity. On the downside, it can help create a two-tier health system and internal brain-drain and thus exacerbate inequality of health provision.[8] Given the new nature of investment in health services, there have been a small number of quality empirical studies in this area. In a recent review, Smith (2004) has gathered three issues which emerge as of most importance, from a review of literature: (1) the extent to which a national health system is commercialized per se is of more significance that whether investment in it is foreign or domestic; (ii) the national regulatory environment and its "strength" will significantly determine the economic and health impact of FDI, the effectiveness of safeguard measures, and the stability of GATS commitments; and (iii) any negotiations will depend upon parties having a common understanding of what is being negotiated, and the interpretation of key definition is thus critical.

One stark fact which comes out of the literature is that the incentives, until recently, have focused in the manufacturing sector rather than in the service sector. Despite this exclusion, perhaps due to its "new" nature, it had been suggested that there is no clear consensus on which package is right for developing countries in general and for an individual country in particular. Designing efficient incentive programs is a complicated task, and the competition between host government trying to attract FDI is likely to complicate the task further, as it tends to shift profits and welfare from the host countries to foreign multinationals (Blomstrom and Kokko, 2003). It is important to keep in mind that the incentives to attract FDI may be seen from two perspectives: capital exporting countries' and capital importing countries'. Most of the incentives are provided by the capital importing countries which exert greater influence than the measures adopted by either capital-exporting nations or international organizations (Meier, 1990 p. 254).

The brief overview of literature shows that most of the literature on FDI focuses on the manufacturing sector of the developed countries. Given the increasing role of services of trade in the world trade, there is a need to highlight the liberalization of this sector and its impact on FDI. Moreover, in today's globalized world, the role of

[7] Examples include India's Apollo group of hospitals, which is opening hospitals in Sri Lanka, Nepal and Malaysia, and Chindex International, a US company providing medical equipped and clinical care in China (Trade in Health Services Across borders: GATS, Markets and Caveats, 2005).
[8] The paper by Smith (2004) provides the first comprehensive and systemic review of evidence concerning FDI and health services.

international institutions such as the WTO promoting the liberalization of services and consequently on service related FDI as shown by the commitments of the countries in commercial presence (mode 3) should be assessed. These are, therefore, gaps in literature in assessing the service sector liberalization of FDI inflows (e.g., assessing how does the domestic policies affect FDI, or what barriers exist in services trade)

3. FDI Determinants and Incentives in Selected Developing Countries with Focus on Health Sector

The literature review in the previous section has identified three major gaps in the literature: (1) focus on developed countries for empirical studies; 2) the role of incentives in the context of globalization and (3) absence of focus on services trade. This section first addresses those gaps by focusing on infrastructure and human capital and the incentives for attracting service sector related FDI, in selected East Asia and South Asia developing countries. For comparison of FDI policies, three countries from South Asia (viz. Bangladesh, India and Sri Lanka), three from South East Asia (viz. Malaysia, Singapore and Thailand) and China were selected. China is selected as the largest recipient of FDI among the all developing countries and therefore provides an important case for other developing countries. Among the Asian countries, India, Malaysia, and Singapore have been successful to attract a high level of FDI. The first and second subsections put forward individual country information with focus on service related investment, followed by a comparative analysis with some observations in regard to health service sector.

3.1 FDI Liberalization with Focus on the Service Sector

This part discusses each of the seven identified countries in regard to four aspects:

- *Country background (with focus on service sector liberalization)* – Various indicators will be examined assessing the level of service sector liberalization: membership in WTO; [9] the number and nature of the multi lateral legally binding (and generally irreversible) commitments made by the countries under the GATS; acceptance of the VIII Article of Association (AoA) of the IMF to liberalize the current account. They give indication of the determinants for FDI.
- *Procedure for FDI* – While the procedures for facilitating FDI are many, the main indicator used in the study is the presence of an effective investment board.
- *Incentives for FDI*- The incentives for FDI attraction are categorized from framework which had been developed, namely: infrastructure; regulatory; and fiscal and financial incentives.
- *Health Services*– This is captured by the two sector in GATS namely the sector on Business services, sub-sector professional services[10] and Health Related and Social Services (HRSS).[11]

The details are provided in appendix 3.

---

[9] This is a complex phenomenon, in comparison to goods liberalization. For example, services trade is affected more by domestic rules and regulations and tariff rates used to measure the barriers to trade in goods are not applicable in case of services trade.

[10] This service sub-sector includes: medical and dental services; veterinary services; and services provided by mid-wives, nurses, physiotherapist and para-medical personnel.

[11] This service sector is divided into four sub-categories namely: hospital services; other human health services; social services; and other.

3.2 Comparison of the Determinants of FDI and Incentive regimes

3.2.1 General Determinants of FDI

The country characteristics in Table 2. of the seven countries show that they cover a broad spectrum in both economic, geographical and population size. These present broad determinants of FDI such as GDP, population and area indicating the market size; openness of trade and the performance of FDI and provide a taste for the determinants of FDI. It is observed that the selected countries are quite varied in their integration with the global economy - proxied by the standard measure of (merchandise) trade openness – on one extreme is Bangladesh which has an indicator of 20.34 percent contribution from external trade while on the other hand is Singapore whose figure is almost fifteen times larger at 297.85%! Similarly, the productivity of labour which reflects the level of skills widely varies; countries with higher productivity tend to attract more FDI.

Among the selected countries China and India have a large area and population- an indicator of the market size for FDI. However, the FDI inflow in China is greater than 10 times to that of India. Even though China is the second largest FDI recipient country second only to the United States, the ratio of FDI inflow to GDP and gross capital formation is not significantly higher than other countries and is lower than Malaysia and Singapore. It can be seen from Table 2. though the countries with greater area and population tend to have higher FDI flow, the magnitude varies. Moreover, though the relationship between the trade openness and FDI inflow is much debated, countries with higher openness to trade have attracted more FDI. Among the selected countries, Singapore far outperforms other countries in terms of the indicators mentioned above.

Table 2: Country characteristics and FDI performance

Year 2003	Bangladesh	India	Malaysia	China	Singapore	Sri Lanka	Thailand
GDP (in million dollars)	51914	600637	103737	1417000	91342	18237	142953
Area (thousand square kilometers)	144	3287	330	9598	1	66	513
Population (in million)	138	1064	25	1288	4.3	19.2	62.0
Trade Openness (X+M)/Y	20.34	21.09	174.79	60.05	297.85	64.69	109.36
Overall productivity (GDP per person employed in US$)	n.a.	7,155	24,923	8,591	49,766	n.a.	13,627
FDI inflows (in million dollars)	460	5335	4624	60630	16060	233	1064
Inward FDI flows as percent of gross fixed capital formation (2004)	3.5	3.4	19.1	8.2	62.7	5.1	2.5
Inward FDI stocks as percent of GDP	6.1	5.9	39.3	14.9	150.2	10.8	29.7

(2004)							
Outward FDI stock as percent of GDP (2004)	0.2	1.0	11.7	2.4	94.5	0.6	2.1
Inward FDI Performance Index	0.263	0.410	1.803	2.134	6.079	0.675	0.506
FDI Potential Index for 2001-2003	0.630	0.700	0.595	0.923	0.629	0.566	0.389

Source: World Development Indicators, 2005 and **www.wto.org**, **www.unctad.org**., World Investment Report 2005, IMD World Competitiveness Yearbook 2004. The UNCTAD inward performance index is a measure of the extent to which a host country receives inward FDI relative to its economic size. It is calculated as the ratio of a country's share in global FDI inflows to its share in global GDP. The Inward Potential Index is based on 12 economic and structural variables measured by their respective scores on a range of 0-1.

However, the inward FDI indices and the potential FDI indices have been mixed, except for Singapore. This simple observation tends to support the view that the overall economic factors and standard measures of foreign investment, do not seem to play a crucial role.

It is interesting to note that the FDI inflows ranking has a high correlation with the Index of Economic Freedom. For example, selected countries with higher ranking have been able to attract more FDI as percent of GDP such as for Singapore which consistently ranks as one of the best destinations for FDI in terms of overall ranking such as the index of economic freedom developed by the Heritage Foundation[12] or the Global Competitiveness Ranking or Doing Business by the World Bank., other, on the other hand, rank poorly (2004; 2006): Bangladesh (3.70; 3.88); India (3.53; 3.49); Malaysia (3.16; 2.98); Singapore (1.61; 1.56); Sri Lanka (3.06; 3.19); Thailand (2.81; 2.99); and PRC (3.59; 3.34). In other words, piecemeal approach to reform and granting of incentives alone will not suffice. More important are transparency and predictability of the rules and regulations, prospects of profitability and the size of the market etc. Thus, we can identify the two tier of good investment climate- one the macro-perspective which include the macroeconomic stability, incentives offered, transparency in legal provisions, political stability etc the latter one is more difficult to measure and capture. The other level is the micro perspective such as the market size, other market players, location of industries etc. which are more specific to each sector.

3.2.2 Comparative Analysis of Regulatory Procedures for FDI and Their Incentives

Examination of all the seven developing countries suggests that they have not made a clear differentiation between FDI of a manufacturing and services nature, much less have defined on any particular service sector. Nonetheless, some general observations regarding incentives for attracting FDI inflows are made. Additional to the

[12] The index of economic freedom is a composite measure of 50 independent economic variables developed by the Heritage Foundation. See http://www.heritage.org/research/features/index for details.

investment board, which facilitates inward flows of capital; all countries have used various incentives. The comparative chart depicting the various incentives and determinants are given in the Table 3..

Table 3. Comparative analysis of FDI regulatory procedures for FDI and their incentives of the selected countries

Particulars	Bangladesh	India	Malaysia	Singapore	Sri Lanka	Thailand	China
Govt. Agency dealing with FDI	Board of Investment (BOI)	Foreign Investment Promotion Board and council	Malaysian Industrial Development Authority (MIDA)	Economic Development Board	Board of Investment of Sri Lank (BOI)	Office of the Board of Investment (BOI)	Ministry of Commerce (MOFCOM)
Regulatory Procedures for FDI	-No prior approval is required for FDI except registration with the BOI in order to avail such facilities such as infrastructure facilities, industrial plot and acquisition of land for setting up an industry.	-Foreign investments approved through two routes: automatic route and government approval. -Where automatic route is not applicable, specific approval from FIPB is required.	-Encourage FDI particularly in export-oriented industries but retains considerable discretionary authority over individual investments. -In case of investments aimed at the domestic market, the government has used this authority to restrict foreign equity (normally to 30 percent) and to require foreign firms to enter into joint ventures. However, a temporary relaxation of foreign-ownership and		-Automatic approval for most investments -One window policy for information -Certain sectors in negative lists -Activities of some industries notably of services subject to approval of other government agencies -Some performance requirements but negotiable	The BOI uses a performance based system that requires promoted investors to submit evidence of compliance with the conditions of their approval in order to claim incentives benefits -Projects investment of 10 million baht ($250,000) or more, excluding the cost of land and working capital will be required to obtain international standards certification, such as ISO 900. -BOI has lifted all local content and export requirements -The BOI pursue a	-Project exceeding US$ 10 million to be approved by the Ministry of Foreign Trade and Economic Cooperation and State Development and Planning Commission. -Projects exceeding $100 million need approval from the State Council. -For projects over $30 million, government officials evaluate each project against official guidelines to determine whether it

			export requirements in the manufacturing sector for those companies that do not directly compete with local producers.			decentralization policy and projects locating in the least-developed provinces will receive maximum incentives -To promote investment in Key sectors, five priority activities have been identified	promotes exports with foreign currency income, introduces modern technology, or provides technical or managerial training.
Infrastructure incentives	-Provision of EPZ -Provision of industrial estates Better facilities in: -Bonded warehouse -Industrial districts/estate	-Provision of EPZs -Non Resident Indians (NRIs) allowed to acquire any property, except agricultural land, Farm House and Plantations Better concessions in: -EPZs, special economic units, export oriented units, software and hardware technology parks	-Incentive given to manufacturing sector for reorganization, reconstruction or amalgamation within the same sector -Free industrial zones (FIZs) areas are specially established for manufacturing companies that produce or assemble products mainly for export - Companies which are	Singapore maintains free-trade zones at the Port of Singapore, Jurong Port, Sembawang, Pasir Panjang Terminal and Wharves, and Changi (Changi Air Cargo, Air Logistics Park).[13] -All dutiable products except for alcohol products and cigarettes may be stored in the free-trade zones. -Customs permits	Provision of EPZs and 2 industrial Parks.	Thailand has eleven export processing zones (or free trade zones), reserved for the location of industries manufacturing for export only, to which businesses may import raw materials and export finished products free of duty (including value added tax). These zones are located within industrial estates, and many have customs facilities	-Established Special Economic Zones (SEZ) in five provinces and designared the entire province of Hainan and SEZ. Prmarily geared to exporting processed goods, the five SEZs are foreign-oriented areas which integrate science and industry with trade, and benefit from preferential policies such as tax holiday or

[13] Singapore Customs (2003b), "Procedures: Introduction".

			engaged in the manufacturing or commercial sector in East Malaysia and the Eastern Corridor whereby expenses incur on qualifying capital infrastructure is given an infrastructure allowance of 100%.	are not required for goods discharged directly into an FTZ or for transshipment of non-dutiable goods unless subject to import restrictions or prohibitions.		to speed processing. -Three investment promotion zones to promote industrial decentralization	reduced tax rates, accelerated depreciation rates, flexible policies on imports and exports. -In addition, a variety of economic and technical development zones (ETDZs) each targeted at a specific industry have been established.
Regulatory Incentive (proxied by the 2004; 2006 index of economic freedom)	3.70; 3.88	3.53; 3.49	3.16; 2.98	1.61; 1.56	3.06; 3.19	2.81; 2.99	3.59; 3.34
Fiscal and Financial Incentives	-Duty free imports for 100 % exports - Tax holidays along with duty free import for export manufacturing -Full repatriation of dividends, interest, profits, divestment, etc -Tax holidays of	-Duty free imports for 100 % exports -Full repatriation of dividends, interest, profits, divestment, etc -10 year income tax holiday for firms located in EPZ -Tax relief under Avoidance of	-Corporations in manufacturing, agriculture, tourism and various other activities may receive "pioneer status" - 5 year tax holiday on 70-100% of statutory income (10 years for companies of	-Concessionary tax rates on international trading activities in approved commodities and products - Tax exemptions for 10 years on income in qualifying products -Concessionary	-Full tax holiday from 3 years to up to 12 years depending upon the nature and the scale of the projects -Concessionary tax rate of 10%, 15% and 20% and import duty exemptions capital and raw	-Main tax incentives include reduction of import duties on machinery and raw materials and corporate tax exemptions. -Corporate income tax holidays up to 8 years	-Considerable reduction in national and local income taxes, land fees, import and export duties, and priority treatment in obtaining basic infrastructure. -Special

	5 to 7 years based on location -50% rebate on export earnings -Tax relief under Avoidance of double taxation -Income tax exemption for power sector - Tax holidays for all FDI in Export Processing Zones (EPZs) for 10 years	double taxation agreements -Ten year tax holiday for knowledge based industries	national/strategic importance) -Investment allowances of 60-100% of qualifying capital expenditure -Exemptions and reduced import duty and VAT rates on inputs in certain sectors especially exporters -Double deduction of certain expenses(e.g. R&D training)	tax rate of 10 % of qualifying offshore income in qualifying products -Under the revised programme approved Singapore-based companies may defer income tax due from their profitable operations in Singapore for two years if their approved overseas investment incurs operating losses during the first three years of investment	materials depending upon the type of the industry		preferences for projects involving high-tech and export oriented investments. -If profit reinvested in China for at least five years, a foreign investor receives a refund of 40 percent. -If profits are reinvested in high technology or export-oriented enterprises, the foreign investor may receive a full refund.

- Regulatory procedures: The examined countries have also highlighted this incentive with the presence of an IB; however from the available information, the procedure for FDI seems to occur at a varying degree, country by country.
- Infrastructure incentives - All the countries have established the export processing zones (EPZs) or the Free Industrial Zones (FIZs) to enable the export-oriented products to enjoy minimal customs formalities and duty free import of raw materials, components parts, machinery and equipment required directly in the manufacturing process as well as minimal formalities in exporting their finished products.[14]
- Regulatory incentive – All seven countries varied in their regulatory incentive.
- Fiscal/financial incentives - All seven countries offer some form of reduced import duty in the case for 100 percent exports, tax holiday (except China), special exemptions from import duties and other indirect taxes. All these countries seem to focus these incentives on foreign investors, exporters, and investments in poor regions.

Table 3 also shows a commonality of incentive structures despite heterogeneity of FDI determinants and economic development. It suggests that FDI incentives are necessary but not sufficient conditions to attract inward FDI. For example, all the selected countries have somewhat similar infrastructure and fiscal/financial incentives accorded in a bid to attract FDI.[15] However, the inward FDI flow or the FDI performance index vastly varies among these countries. This suggests that the remaining regulatory incentive can play a major role in FDI inflows. This may be because the regulatory provides an indication of the investment climate.

3.3 Liberalization in Services and Health Services

The selected countries are similar in their commitment to integrating with the global economy, reflected by universal membership in WTO and acceptance of the VIII AoA of the IMF for current account liberalization. However being of disparate economic sizes and openness (as had been shown in the earlier table) which can also be seen in the different number of committed service sectors.[16] A snapshot of this is provided in the Table 4.

---

[14] However, care should be taken in that many countries have laws related to EPZs that are different from national labor legislation and privileged treatments are given to production or supplying of services and that production for domestic markets is taking place on less favorable terms than that of exports which might be a distortion of WTO rules.

[15] This conclusion is consistent with Donges (2005) who also found through a comparative analysis of the fiscal and infrastructure incentives do not seem to exert a major influence on the FDI inflows. Even if other determinants are more important than incentives, these measures are not completely ineffective in influencing the location advantage. It seems that once the decision to invest in a broad region is made, incentives can be a decisive factor for a certain location within this broad area.

[16] Having less experience in services trade with respect to the consequences on their economic development and national capacity building, most countries were relatively careful in undertaking liberal commitments

Table 4 Some indicators of investment liberalization in the service sector

	Bangladesh	PRC	India	Malaysia	Singapore	Sri Lanka	Thailand
WTO membership (date)	1 January, 1995	11 December, 2001	1 January, 1995	1 January, 1995	1 January, 1995	1 January, 1995	1 January, 1995
Article VIII of the AoA of the IMF	1994	1996	1994	1968	1968	1994	1990
Share of services in GDP	52	51	42	33	65	55	46
Number of GATS service sector commitments	2	9	6	9	7	3	10
Number of multilateral trade treaties ratification[17]	55	90	85	66	70	77	55

Source: www.wto.org, World Development Indicators,www.tradeforum.org and compiled from other sources.

The examination of identified country FDI policy suggests that there has been little mention differentiating goods and service related investment; this implies that services may not have been a priority to national governments at that time despite its growing importance to a nation's economy. The focus of this paper's analysis, however, is on liberalization in the health services sector. In this regard, a minority of WTO members had committed to health services: by 1998, a total of 59 countries had included one or more aspects of health services in their GATS schedules of specific commitments (Butkeyiciene and Diaj, 1998). This reluctance, seen in only a third of WTO members at that time, have committed to health services, may be since the benefits are balanced by the costs; with developing countries perceived to have poor institutional mechanism to adopt safeguard measures, enforce standards monitoring of public health system etc. In addition, domestic policy environment, regulatory and infrastructure conditions also put a barrier to liberalization of the health sector.[18]

---

in market access. This scenario has not changed so far. Among the various modules of trade in services, countries are working out for opening those areas on the basis of experiences of countries at similar stages of economic development, resource endowment and market potentials. This is true for the seven examined countries which can be grouped by their WTO service related commitments: (1) limited commitments: Bangladesh has scheduled less than 20 sub-sectors; (2) average commitments: India, Singapore and Sri Lanka who have committed between the 21-60 sub-sectors; (3) large commitments: Malaysia and Thailand have scheduled more than 61 sub-sectors (Development, Trade and WTO: A handbook, p262).

[17] International Trade Centre (ITC) has developed an index based on the number of trade treaties and their 'importance' on trade. For details, see
http://www.tradeforum.org/news/fullstory.php/aid/939/Trade_Treaties_-_Where_does_your_country_stand_.html

[18] This may also be due to health services in developing countries being mainly provided by the government sector.

Given the general reluctance for its liberalization it is unsurprising that only three of the seven countries - India and Malaysia and Singapore - have committed for this sector under the GATS. Malaysia has made the most liberal commitments. It has scheduled two health sub-sectors and viz. Medical Specialty Services and the Private Hospital Services made no restrictions on the modes 1 and 2 on these sub-sectors. Singapore, has scheduled three service sub-sectors related to health services sector viz. Medical Services, Dental Services and the Veterinary Services but these sectors are classified under the Professional Services under the WTO service sector classification and therefore, can't be said to have made proper commitments on the HRSS. India, on the other hand has scheduled only one sub sector i.e. Hospital Services. Modes 1, 2 and 4 are restricted whereas in mode 3, the hospital services are allowed through incorporation with the foreign equity ceiling of 51%.

4. Implications for Liberalization of FDI in Services Sector in Nepal with Focus on Health Services – A Roadmap

This chapter examines Nepal and uses information provided in previous chapters to critically analyze incentives in the country and provides a road map for liberalization with focus on the health sector.

This chapter proceeds in three parts: the first part describes Nepalese situation through a general background of the Nepalese economy and its experiences in economic liberalization, the procedure and incentives for investment and the domestic health services sector; the second part analyses Nepalese present situation in light of the experiences of seven developing countries in the last chapter, to highlight gaps in incentives; the final part links the lessons and puts forwards a roadmap for Nepal, taking into consideration the existing situation, with focus on domestic health services. Some observation will be provided in making this roadmap into a liberalization strategy for FDI, with focus on health.

4.1 Nepal - A general Introduction

Background:[19] Nepal, the LDC located in south Asia, started the liberalization process of the economy in the mid 1980's which had accelerated in the decade of the 1990s, reflected in part with acceptance of Article VIII of the AoA of the IMF on May 30, 1994, for an open current account. Nepal had also become the first LDC member of WTO through the normal accession process. The country is presently facing a domestic insurgency with the Maoists of Nepal, which had halted growth of the country. As such, there is deteriorating quality of infrastructure, low level of skills and human capital and instability in the regulatory environment. Index of economic freedom for Nepal is 3.53; in comparison to the above mentioned for the seven countries, Nepal is the least free except for Bangladesh which ranks slightly higher.

Procedure for FDI: HMG/N adopted the strategy of enhancing the participation of the private sector including FDI in all sectors of the economy, to spurting the country's economic growth and development (NPC, 1992).[20] In this regard, HMG/N formulated the Foreign Investment and One Window Policy based on which the Foreign Investment and Technology Transfer Act, 1992 (FITTA, 1992) and Industrial Enterprise Act (IEA, 1992) were promulgated (amended later in 1996 and 1997). [21] In December 2001 Nepal had

---

[19] A detailed discussion is given in appendix 4.1.

[20] Foreign investment and technology transfer existed prior to 1981. The Industrial Policy and Foreign Investment and Technology Transfer Act 1981 paved the way for regular inflows of foreign investment in Nepal.

[21] The FITTA, 1992 and IEA, 1992 are the acts governing foreign direct investment in Nepal. The Department of Industries (DOI) is the sole agency for administration and implementation of foreign investment and to deal with issues such as trademark, patent, design etc. A foreign Investment and Technology Transfer Section has been constituted under the DOI. A One Window Committee was constituted under the Industrial Enterprises Act 1992 under Section 17 for the purpose of making available

also formed a Board of Investment (BOI, Nepal) under the chairmanship of the Prime Minister, with the aim of promoting investment and making it more transparent and reliable. The other objectives of the Board includes formulation of new policies by reviewing the existing investment policy, maintaining coordination between various government and non-government organizations for the promotion of investment, pinpointing the areas of priority sector for investment promotion, monitoring the activities associated with investment promotion and providing directives to the concerned department to boost up investment (Pant and Sigdel, 2004). The creation of these diverse bodies (e.g. one window and BOI, Nepal) has fueled the debate on the functions of such "one stop shop" when law or rules do not clearly specify the authority responsible for providing such services or when they are not adequately authorized to make all relevant decisions, a situation that has also been faced by Nepal (WDR, 2005).[22] In this vein and unsurprisingly, Nepal does not make a clear differentiation between manufacturing and service FDI however those are being addressed in the Legal Action Plan committed to during the WTO accession process.

4.2 Incentives for FDI

Nepal has committed to provide a wide range of incentives to attract foreign investment in the country. These incentives can be broadly categorized into fiscal and financial, infrastructure, skill and regulatory incentives

- *Fiscal and financial incentives:* HMG/N has committed to impose corporate income tax not exceeding 20 % of profits; a 5% income tax on dividends (tobacco and alcoholic products excluded); income tax on export earnings not exceeding 0.5% of the total export amount. Income tax rebate has been provisioned for industries on the basis of locations in underdeveloped regions, utilization of local raw materials and employment opportunities offered to Nepalese citizens. There are additional incentive provisions related to technology, efficiency or product development and income spent for advertisement of the products, promotional services, and hospitality services. Similarly, customs duties are imposed at concessional rates and full exemption from sales tax are offered for specified manufacturing industries importing plant, machinery and equipment required for direct production process. Export oriented industries can import raw materials by

---

the facilities and concessions to be enjoyed by any industry under this Act in time from a single place (see Annex I). The DOI acts as a secretariat of the one window committee with a procedural manual for foreign investment has been published by the DOI (2005) to ease understanding of FDI procedures in Nepal.

Accordingly, prior to establishing a firm under foreign investment, the foreign investor will have to incorporate the company at the Company Registrar's Office, register the industry at DOI, register at Inland Revenue Office to get a Permanent Account Number (PAN) and obtain permissions for trademarks/ patents/ designs if necessary. Regarding making equity investment with a Nepalese company, approval from the DOI suffices. A time bound decision process has been set up such that for companies with completed document, the decisions with regards to industrial license, registration, duty drawbacks are made within 30, 21 and 60 days from the date of application respectively.

[22] Earlier studies have also indicated that the one window system in Nepal has been bureaucratic and time consuming which has led to corruption and additional costs imposed on the investors. As a result they have turned out into additional burden- "one more window" instead (Pant and Sigdel, 2004).

entering into a passbook without paying any custom duty or sales tax. The raw materials are deducted from the passbook upon export of finished products. Rebate in the excise duty apply for industries located in underdeveloped regions respectively for a specified duration from the date of operation and for industries utilizing locally available raw materials, chemicals and packing materials etc. Any duty or taxes levied on the raw material, auxiliary raw materials etc. used in producing goods for export are entitled to get refund of these duty and taxes based on the quantity of export.

- Similarly, provisions have been made for the repatriation of profits and dividends, salaries and allowances, amount received from the sale of the share of foreign investment, the amount received as profit or dividend from foreign investment; the amount received as payment of principal and interest on any foreign loan; the amount under agreement for technology transfer. Likewise, foreigners and companies can open and operate foreign exchange accounts in any of the commercial banks of Nepal. Export oriented industrial companies can also open foreign exchange account. Industries incorporated as 100 percent foreign owned or as a joint venture may also open a foreign exchange account to deposit the equity share of the foreign party in convertible currencies.
- *Level of infrastructure facilities and incentives:* HMG/N has commitment to give priority to arrange infrastructures required for the establishment of industries and to provide government land or industrial districts for their establishment. However, due to lack of adequate infrastructures in all parts of the country, explicit commitment has been made for priority in the provision of electricity connection only. It is also important to note that HMG/N has been expressing commitment for establishment of EPZ but as of yet, no progress has been made practically.
- Presence of skilled manpower and incentives: HMG/N has committed to allow capitalization of pre-operating expenses incurred in connection with skill development and training. With regards to existing skill situation, the national adult literacy rate for the country is 48 percent. There are five universities providing education in engineering, medicine, science and technology, management etc. The IEA, 1992 has made provision of recruiting manpower required for any industry from among Nepalese citizens. However, if any industry cannot be operated with Nepalese citizens, expatriates or foreign nationals can be appointed with prior approval from the Department of Labor from a maximum period of five years with provision for an additional period of five years.
- *Regulatory procedures and incentive:* foreign investors can own up to hundred percent in equity share. Foreign investments are open in all areas except a few (consisting of industries related mainly to tobacco, alcoholic and security). The IEA, 1992 has guaranteed that there will be no nationalization of privately owned industries. Except industries that affect security and public health, no other industries need to obtain any license or permission for establishment and operation. They just need to be registered with the concerned Department. Time bound decision processes require decisions regarding industrial license; registration and duty drawbacks to be made within 30, 21 and 60 days from date of application respectively. Non tourist visa for carrying out studies for

investment and business/ residential visa for foreign investors are provisioned to enhance further simplicity. Licenses are not required for the export of products other than banned items or quantitatively restricted items as notified by HMG/N. In case of quantitatively restricted items, export licenses will be granted in consultation with the private sector. Exports will be charged minimal taxes.

It is important to point out that the Nepal does not make a clear differentiation between incentives for manufacturing and service FDI.

4.3 Health Services

The Nepalese health care system is described in appendix 4.3.

Nepal, as the LDC with a relatively backward health sector, is an importer rather than an exporter of health services. In this regards, the country has to liberalize its health sector without adversely affecting the domestic health sector in the short run while targeting to enhance its capacity in the long run to participate as an exporter of health sector in the global market. Experiences of other developing countries reveal that among the four different modes of services, commercial presence is the most appropriate mode for health sector liberalization at the first step (Chanda, 2001). In consideration with the role of the private sector recognized in the provision of specialized health care services, hospital services and ownership and management 'on fee basis' have been opened for market access and national treatment without any restriction in respect to cross-border supply, consumption abroad and commercial presence except that market access through commercial presence will be allowed only through incorporation in Nepal with maximum foreign equity capital of 51 percent. Presence of natural persons has been restricted except as specified in general (horizontal) commitment. It has also been specified that medical experts can work for one year's maximum with the permission of Nepal Medical Council (Annex IV). [23] HMG/Nepal has also identified commercial presence as the most practical entry point for liberalization of trade in the health sector.

4.4 Gaps in Investment Incentives and Determinants

This part examines Nepal's present situation in light of the experiences of seven developing countries in the last chapter, to highlight gaps in incentives. Table 5 provides an investment incentive gap analysis matrix).

[23] It comprises of medical and paramedical services, nursing services, laboratory and technical services including radiological and anaesthesiological services etc extended mainly to inpatients. Hospital and related social services refers to hospital services and direct ownership and management by contact of such facilities on a "for fee" basis.

Table 5 Gaps in Nepal's Investment Incentives

Incentives category	Maximum and minimum Incentives	Nepal Incentives	Gap
Incentives in regulatory procedures for FDI	Government approval through registration only or approval procedures that are liberal (particularly towards export oriented industries)	- No need for license and permission; simply registration with the DOI (except for industries related to security and public health)	- No gap
	A number of bodies exist to promote FDI flows and to translating FDI approvals into implementation.	- The DOI is the sole institution;	-Incentive inadequate
	Identified key sectors to facilitate investment along with incentives	Government can grant additional facilities to industries that belong to "National Priority Industries";	- provision for limited sectors and incentives are not explicitly expressed and are subject government discretion
Infrastructure incentives	-Provision of EPZs and Special Economic Zones (SEZs), software and hardware technology parks	-No EPZs, SEZs and software and hardware technology parks so far	-Incentive missing
	Provision of infrastructure allowance that can be utilized to offset against statutory income tax and can be carried forward to following years until it is used up	-No provision	-Incentive missing
	Various Economic and Technical Development Zones (ETDZ) each targeted at a specific industry	-No provision	-Incentive missing
	Well developed transportation system including road, railways and harbors; Well developed communication, banking and insurance services. Adequate power, and water supply infrastructure.	- Basic infrastructure s such as power, communication and transportation are not adequately developed.	- Incentives inadequate
Fiscal and financial incentives	Max: Duty free imports for 100 percent exports Min: Reduction of import duties on machinery and raw materials or corporate tax exemptions	Taxes and duties paid on raw material and auxiliary raw materials refunded for 100 percent export	- No gap

	Max: Tax holiday along with duty free imports of capital machinery and raw materials import for export Min: Minimum 3 years of tax holiday	- No tax, fee or charge on machine, tools, equipment, machinery employed by and the product of the export promotion industry	-No gap
	Income tax exemption for national /strategic importance; "Pioneer Status" to industries in specified sectors ; concessionary tax rates on international trading activities in approved commodities and products; full tax holiday for 3-12 years depending upon the nature and scale of the project	10 percent income tax exemption to industries (except tobacco and alcohol) using 80 percent of domestic raw material and local manpower OR providing direct employment to 600 persons or more than 600 Nepalese citizens around the year	-Incentive missing and incentives lower than optimal incentives
	Max: tax holidays for 3-12 years based on locations Min: No tax holiday in China	15-35 percent rebate on excise duties for 10 years based on locations and by nature of the product (fruit based)	-incentives lower than ideal rate and restrictive
	Max: Full repatriation of dividends, interest profits, disinvestments Min: Profit required to be reinvested at least for 5 years to receive a refund of 40 percent	-Full repatriation of profit, dividend, principle and interest receipt	- No gap
	- 10 years tax holidays for industries located in EPZs	-No EPZ established so far.	- Incentive missing
	- Tax relief under avoidance of double taxation	No double sales tax on raw material and products	-Incentive exist for sales tax but not explicit for income and other tax
	-Special preferences for projects involving high-tech and export oriented investments	No provision	-incentive missing
	Ten years tax holiday for knowledge based industry	No provision	-Incentive missing
	Double deduction of certain expenses (e.g. R&D training)	No provision	-Incentive missing

	-40 percent refunds if profit reinvested for more than 5 years	-deduction of 40 percent of the value of reinvested fund in computing taxable income	-incentives lower than ideal rate
	-profit reinvested in high technology export oriented enterprise receive full refund	No provision	-Incentive missing

Gaps in Regulatory procedures for FDI: The procedures for granting permission and registration have been liberalized with provision to be completed within a specified period of time so that cumbersome bureaucratic procedures are avoided. However there are no provisions for specialized institutions to facilitate FDI flows and translate approvals into implementations. This results in many approved FDI not being implemented. The government has not adequately identified key sectors for facilitating them with adequate incentives. These are the specific gaps. More important gaps, however, exist in the general regulatory structure and performance of the government.

According to a UNIDO study (2002), bureaucracy in Nepal suffers from poor delegation of authority, inadequate dissemination of information, lack in clarity, consistency and simplicity of laws and regulations, overly rigid application of rules, and absence of accountability. Tax administration suffers from tax officials having too much discretion on tax assessments, and the absence of workable system for resolving tax disputes. Customs administration suffers from five key problems: procedural delays and complicated documentation (an average of 80 documents for export), inaccurate classification of goods (leading to arbitrary decisions, delays and rent-seeking), inaccurate valuation of goods (due in part to the use of reference value rather than invoice value), delays in the duty drawback scheme and VAT refunds (six-month delays are common), and lack of enforcement and smuggling (especially due to price differentials with India). Further, Government policies and regulations suffer from frequent changes without prior and adequate consultation with businesses, including changes in tariff rates and currency regulations. Frequent changes in the government that Nepal has been experiencing during the last few years would also lead to lack of confidence in the regulatory environment among foreign investors (the country witnessed 10 governments within 8 years).

Further, there are problems in the labor legislation and administration as well. Labor law in Nepal stipulates that permanent workers cannot be dismissed without prior approval of the Department of Labor, a process which can take months or even years. More often, firms have switched to recruiting foreign workers on a temporary and contract basis. FDI inflows require that various government policies are well coordinated and effectively implemented by concerned ministries and agencies. The One-Window Committee needs to be strengthened with representations from land and infrastructural agencies, because the availability of land, power and other infrastructural needs are major bottlenecks for investors.

Gaps in the level of infrastructure: Lack of physical infrastructure is one of the greatest obstacles to FDI in developing countries including Nepal.[24] According to a survey undertaken by the Nepali Federation of Chambers of Commerce and Industry (FNCCI) and the World Bank in 2000, over 70 percent of firms experienced problems with electricity, and 42 per cent experienced severe problems in this respect (figure 4). About 35 percent of firms experienced problems with the road network, and 31 percent experienced problems with water supply. Some 20 per cent experienced problems with telecommunications, while 15 per cent experienced problems with water disposal. The country needs to assure foreign investors on the provision of these basic infrastructures before EPZ, Special Economic Zones (SEZs), and software and hardware technology parks can be established in Nepal. Infrastructure allowance that could compensate for lack of these special zones does not exist. Some countries offer infrastructure allowances that can be used to offset against statutory income tax that can be carried forward to following years until it is used up. There are no Economic and Technical Development Zones (ETDZs) targeted at specified industry so far.

Gaps in skill and human capital: Supply of multi-skilled labor force and managers is an important factor for attracting and enhancing FDI flow. In course of analyzing the long withstanding weakness of Nepal regarding FDI, the UNIDO report on Industrial Development Perspective Plan 2020 (UNIDO, 2002) has identified lack of quality of human resource as a serious bottleneck. This is mainly due to inherent weakness in the primary and secondary education system. The manpower produced at home is more of a general category rather than specialized manpower. There is a shortage of high-tech manpower due to the lack of such training institutions in the country. Successful countries grant full income tax exemption at statutory level for five years to industries with “Pioneer status”. No such provision exists in Nepal. There is no adequate tax concession for investment on R&D either.

Gaps in fiscal and financial incentives: fiscal incentives are lacking in the provision of income tax exemptions to certain sectors that could act as sectors of national/strategic importance. Firstly, there is a need to identify such sectors. There is no provision of “pioneer sector industries” in Nepal- a provision that exists in some successful countries, for which tax holidays can be granted for a specified number of years. Though incentives have been granted they are lower than optimal rates and are limited by restrictions. Since Nepal has no EPZs established so far, some alternative fiscal provision would compensate for it. No provision of special fiscal incentives for high preference project such as high-tech and export oriented investment, knowledge based industry exists. There are no adequate provisions for deduction of expenses on R&D.

---

[24] Infrastructural problems continue to be India’s biggest bottleneck for FDI in India and India has placed first priority on infrastructure sector (energy, transport and communications, cement, and so on). For details, see Pant and Sigdel (2004).

Gaps in the health sector: Nepal possesses some distinctive feature from the perspective of the market for health sector. The country is small in size and population while the per capita income and purchasing power are very low. The market is also highly fragmented due to lack of transportation network throughout the country. About 86 percent of the population lives in the rural areas that lack primary and basic health services (CBS, 2004). Mostly the high and middle income urban population enjoys the secondary and tertiary level health care that is provided by public health facilities at highly subsidized costs. Thus, the market for health services is highly distorted. Absence of domestic health insurance market and prohibition on private foreign investment on health insurance is one of the factors limiting private sector participation in the health sector and is very much true in case of Nepal (UNCTAD-WHO, 1998). An alternative approach to health insurance or hospital service alone is the 'managed care' which consists of a system of financing and delivery of medical care through contracts with selected physicians and hospitals and links with insurance companies is also missing in Nepal.

In view of the small size and distortion in the market for health services, there is a need for a bold policy initiative through increased participation of the private sector in secondary and tertiary health care to the urban population. This calls for identifying the gaps to attract the private sector for participation and providing adequate incentives to meet them. Gradual shifting of the tertiary health care from the public to the private sector will reduce a significant burden presently being borne by the government. It will at the same time release large amount of resources for expansion and strengthening of the primary and secondary health care, particularly for the rural population. It will also make available the benefits of this new kind of health care organization through expanding network of information technology in peripheral regions through tele-diagnosis and telemedicine, surveillance for epidemic control etc. to the rural population at reduced costs (Chanda, 2001). This requires making private and foreign investment in tertiary health care very attractive.

The gaps discussed for FDI in general applies to the health sector too. However, identifying the gaps specific to the health sector is quite difficult as there is a lack of experiences based on which lessons can be drawn for Nepal. This is for the reason that liberalization in the health sector with explicit commitments under GATS is only a recent phenomenon and countries are moving ahead with caution.

In addition, regarding the roadmap for Nepal, filling those gaps in general discussed above may not suffice to attract foreign investment in the health sector due to the small size of the domestic market and profitability considerations. This should be compensated by other investment incentives including significant fiscal incentives such as tax holidays or tax rebates to health facilities specifically in their input side. The consequent fall in the tax receipt as a result of the decline in tax rate for the time being will have to be accepted. Such a decline in the tax rate might be offset by increased tax base once the process takes momentum. Foreign investments related to human resource development should be given special treatment in recognition to their contribution in developing national manpower. In view of the above considerations, the gaps that exist in investment incentives specific to the health sector in Nepal can be outlined as follows.

(i) Gaps in FDI procedure: none.

(ii) Gaps in infrastructure incentives: special provision of acquisition/leasing of land necessary for health facilities under foreign investment are not explicitly stated. The government has no provision of water supply, sewage, transportation etc (provision exists for priority in electricity connection) to foreign establishments in the health sector.

Gaps in the level of skills: The government sector itself is short of manpower in the health sector. Many hospitals at district level remain unattended by doctors. There is shortage of supporting technical manpower. In spite of high demand for such studies, the existing intakes have not been increased due to the lack of appropriate planning and resource scarcity. The qualification of most of the existing manpower is low from international standards (UNIDO, 2002).

(iii) Gaps in regulatory procedures and incentives: Institutional development of a government bureaucracy committed to the rule of law is said to be missing in Nepal due to political instability for a long period of time. Frequent changes in government lead to frequent reshuffling and mismatched deputation of manpower. As a result there is a lack of experienced, competent and visionary leadership in the government machinery. Ministries and departments make *ad hoc* decisions due to lack of confidence and lack of qualified manpower to monitor the implementations of the decisions. Due to the centralized nature of development in the past few decades, poverty and inequality has been increasing and this has been exacerbated by the ongoing conflict. Liberalization of the private health sector without adequately strengthening the public health sector particularly that has been catering to the need of rural population is likely to aggravate the situation and add fuel to the ongoing conflict. The skill and tactful leadership to maintain a delicate balancing of the equity and efficiency aspect in health care is missing in Nepal.

(iv) Gaps in fiscal and financial incentives: Special fiscal incentives to attract investment in health sector are lacking. Zero tax rates on imports of construction materials, equipment and medical supplies used by health facilities are missing. Rebates on consumption taxes on health services are missing and so are the taxes on the profits. Teaching hospitals have not been granted with rebates that knowledge based industries have been granted in other sectors. There is no provision of government guarantying loans from commercial banks to foreign establishments.

The health sector, due to its more technical nature on the one hand and due to its sensitiveness related to human health, is more prone to this kind of situation. Most proposals for reform and liberalization in the health sector remain undecided due to the lack of competent institutional structure for monitoring of quality of health care, the tax system etc. Government regulations are conservative, not timely, ad hoc and hinder investment environment.

4.5 Roadmap to Fill the Investment Incentive Gaps in the Health Services Sector[25]

The previous section highlighted the investment incentive gaps that were present in Nepal and had also focused on the health sector. This section provides a road map for bridging those gaps specific to the health sector, linked with the previous chapter especially focusing on lessons to be learnt from individual countries, which can be easily generalized.

Prior to proceeding, it is important to point out that an important incentive for stability highlighted earlier, is absent in Nepal for the last couple of years due to existing security situation and armed insurgency. It is felt that unless this situation is addressed, there is very less scope for attracting FDI into the country. Nonetheless, this exercise provides the necessary environment which can be developed in parallel with the process for peace in regard to liberalization of the health services sector.

Among the three major issues of trade in the health sector identified in course of the review of a wide range of literature, Smith (2004) has identified the "extent of health system commercialization is more important than whether investment is foreign or domestic". In the context of Nepal also the poor performance of the public health care system is a motivating force for its decentralization and commercialization. Commercial presence without adequate homework that exacerbates transitional dualism between the private and public sector may aggravate the situation further.[26] In this situation, making adequate ground work for the liberalization process to take off once the normal situation is restored appears to be the best strategy. In this regards, the timing, sequencing and the pace has to be taken into consideration while focusing to take full advantage of the opportunities made possible by increased trade in health services (Maskay, 2004).

The following roadmap has been suggested with regards to enhancing the trade in health through commercial presence and other three modules in the long term. This has been done with regards to the three aspects: timing, sequencing and pace of the various components of the liberalization process.

Timing: Due to the conflict situation existing in Nepal, the activities of the government has been confined to the urban centres only. There is an absence of investment climate due to the unstable and volatile situation. Government budget

[25] This part also draws from the discussion with policy makers in the health sector at various levels. Policy makers pointed to the scope of developing the domestic health sector with prospects for serving external market through improved regulatory environment that enhances improvement in the quality of services.

[26] In this regards, HMG/N has paved way for commercial presence as is indicative of its strategy to provision cardiac, neurosurgery, organ transplant, cosmetic and trauma management as highly specialized health services through the modality of public private partnership in its Nepal Health Sector Programme – Implementation Plan (NHSP-IP), 2003-07 (HMG, 2003). This strategy was adopted with the objective of recognizing and developing the role of the private (and NGO) sector in the delivery of health services with participative representation at all levels which ensure consumers get access to cost effective high quality services that offer value for money (MOH, 2003)

allocation priorities are more biased towards security while expenditure in the infrastructure and expansion of social sector are curtailed. Due to the absence of an elected government, major decisions related to policy incentives are *ad hoc* in nature. In the absence of the parliament that was dissolved a few years back, the policies and laws that govern foreign investment are promulgated by means of ordinances which are characterized by six month's validity. This makes the situation very much unpredictable and uncertain. In this situation, liberalizing the trade in health services, in general, has to be postponed until there is improvement in the law and order situation. Ensuring that the operating firms under foreign investment work smoothly approved projects are implemented is already a challenge, given present scenario in Nepal.

There can be some scope for continuing liberalization in limited areas. For instance a large number of students go abroad for medical education. In that regards, there is enough scope for medical colleges in Nepal. Such medical institutions can be established in urban areas where security does not appear to be a big problem. This will help improve the skill incentives in the future and also reduce the burden on secondary and tertiary public health care in urban areas. Provision of free beds to the poor in such facilities will also help to reduce inequality in health care- an issue that is often associated with liberalization of the health sector. Similarly, there is an increasing educational market for secondary level manpower such as nursing, lab-technicians, radiologists etc in the health sector. If conducive environment can be created, investment under joint venture can be attracted because of the more labour intensive nature of these undertakings. Liberal regulatory policies and fiscal and infrastructure incentives such as free provision of land, tax exclusion on import of construction materials, equipments etc can help to attract such investment. This will also help towards development of an investment friendly attitude towards foreign investment.

Another potential area is the opening of the market for health insurance targeting the urban population. Development of the market for health insurance and managed health care has been considered as a vehicle for upgrading the quality of health service along with reduced prices for health services through enhanced competition in the health care market.

Policy Coherence: Lack of infrastructure, shortage of high quality and efficient health manpower and a reliable, honest and efficient government bureaucracy are the most desired requirements for foreign investors. However, in view of the situation discussed above, no major breakthrough in all these aspects is possible, at present. Even if a situation of normality is restored, it will take time to overcome these problems. In this regards, the process of institutional reform can be worked out at no significant extra cost that would complete the groundwork for the future. Broadly, it is felt that the order of sequencing of this ground work should be in order of infrastructure and human resource development, regulatory environment and fiscal and financial incentives. The components of these measures may consist of the following with sequencing based on analysis of the maturity of the situation

- Development of a long term strategy for foreign investment in the health sector in the various four modules of trade in services on a stepwise manner.

- Making provision for opening up private sector involvement in the infrastructure sector such as electricity, water supply, transportation, communications, and air services (Chanda, 2003).
- Formation of an education board to revise syllabus in the health sector to provide students with latest technology on a practical base that builds up their capacity to meet different technical requirement and equip them with modern management skills.
- Restructuring education and training institutions run under public budget or by attracting private sector. Collaboration with foreign institutions might be encouraged to ensure quality of the products. mechanism to monitor the quality of the products should be developed.
- Undertaking initiatives for the development of the health insurance sector that targets tertiary health care to the urban population as targeted by the health sector policy of HMG/N
- Institutionalizing the mechanism of periodic interaction between the government and the Foreign investors in the health sector to identify obstacles and measures to overcome them
- Instituting the mechanism of regular interaction between the government and the non-resident Nepalese (NRN) to encourage them for investment once normal situation is restored
- Activating the BOI and restructuring it for representation of the health sector
- Delegating the One Window Committee with necessary authority and institutionalizing the system of prompt feedbacks related to approval and provision of facilities stated in the regulations. (The MOH should also be represented in the new structure of the committee)
- Reform visa procedures (speedy provision of visa, multiple entry visa, increased duration for residence visa)
- Publicity and information of the investment opportunities available in Nepal in the health sector (government's intention to facilitate establishment of sanitariums, dissemination of success stories of teaching hospitals etc).
- Establishment of an effective monitoring mechanism to ensure quality of health care services provided through private and foreign investment.

Pace: Nepal is a traditional agrarian society with masses of people living under abject poverty. The failure to translate liberalization in the political sphere in the 1990s into social and economic lives of these impoverished population led to the armed uprising in Nepal that has led to loss of lives of more than 13 thousand people and conflict induced migration of thousands. One of the greatest threats of liberalization of the health sector is the dual health care structure with a primitive and impoverished health sector at the periphery and highly sophisticated state of the art health facilities in the centre. Thus while undertaking liberalization in health sector, adequate care should be given to ensure that the pace of decentralization and upgrading of rural health services do not lag behind the growth in urban secondary and tertiary health care. Thus the pace should be a slow and consistent one rather than of a big bang nature (Maskay, 2004).

5. Summary and Conclusion

The study focuses on the experiences of liberalization strategies and incentives for attracting investment in (health) services of selected developing countries – Bangladesh, India, Malaysia, China, Singapore, Sri Lanka and Thailand. The study finds that the countries are quite varied, e.g. economic size, area, population etc. On the other hand, the incentives are similar in both their non-specific nature to services as well as the general ranges of incentives offered, although having variations in regulatory incentive. It was observed from the countries examined, that there did not appear to be a clear relationship between the incentives (liberalization strategy) and FDI flows; the exception is the regulatory incentive which perhaps gives an indication of the investment climate – this has a strong relation with FDI flows.

Further, of the seven above mentioned countries, only three – India, Malaysia and Singapore – have made limited multilateral commitment in the health sector – confirming reluctance in this sector. Again, this reluctance may be due to countries not being confident enough in the control they can have in this sector (through appropriate regulation, supervision and monitoring) despite having acknowledged the importance of investing in health. This suggests a need for case studies to examine countries with both successful experiences and accessible information – this may be on developed countries whose information can be interpreted for country situation.

From those experiences, the study has provided a road map for the future liberalization - investment in general and health services in particular - in Nepal. The study finds that the country does have a facilitating mechanism however there is presently confusion since there exists more than one, without clearly defined authorities. Furthermore, gaps have been highlighted in the above mentioned broad incentive in comparison to those found from the examined developing countries. A roadmap of an investment liberalization strategy, is produced which tries to bridge those incentive gaps with particular attention being paid to appropriate regulation of health investment. Finally, three points are interjected for implementing this roadmap given the present condition in Nepal; these are: timing, sequence, and pace.

It should be noted that all these incentives reflect investment liberalization which try to make a hospitable environment for FDI. However political and economic stability may still be the crucial factor in determining the level of FDI – both in general and with regard to service and in particular health. An important area for the future research is what constitutes an effective package of reforms regarding the regulations of the services according to the country specific situation. In other words, it is observed that emphasis seems to be on the determinant of the investment climate, discussed earlier.

It is therefore concluded that for Nepal to capture the benefit of investment liberalization, it must continue enhancing the existing facilitating mechanism, the determinants of FDI along with the incentives in the services sector. Ensuring a stable domestic environment will be much more important to win confidence among investors.

In other words, despite the roadmap for Nepal, it is felt that a more “difficult” road lies ahead for the country in attracting investment in general and specific to services (health).

References

Adhikari, Shiva Raj, Nephil Matangi Maskay and Bishnu Prasad Sharma. "Nepalese Health Policies: Some Observations from an Economic Development Perspective." *Economic Review (of Nepal Rastra [Central] Bank).* **Occasional Paper Number 14** (April 2002) 55 – 72.

Adhikari, Shiva Raj and Nephil Matangi Maskay. "Health Sector Policy in the First Decade of Nepal's Multiparty Democracy: Does clear enunciation of health priorities matter?" *Health Policy* **Vol 68/1** pp 103-112 (2004).

Alexander Lehmann, Natalia T. Tamirisa, and Jaroslaw Wieczorek, 2003. International Trade in Services: Implications for the IMF, IMF Policy Discussion Paper, December, 2003.

Asian Development Outlook, 2004. Part 3 Foreign direct investment in developing Asia.

Athukorala, Prema-chandra and Sharma, Kishor. Foreign Investment in a Least Developed Country: The Nepalese Experience. ASARC Working Paper No.2004-05.

Bajpai, Nirupam, 2004. Foreign Direct Investment in China's Provinces: Lessons for the state of Gujarat

Banga, Rashmi (2003): Impact of Government Policies and Investment Agreements on FDI Inflows, working Paper Nr. 116 (New Delhi: Indian Council for Research on International Economic Relations), http://www.icrier.res.in/WP116.PDF,

BOI, 2003. Bangladesh FDI Inflow Survey N0.2. Dhaka: Board of Investment.

Blomstom, Magnus and Kokko, Ari. The economics of foreign direct investment incentives. Working Paper 168, January 2003.

Blonigen, A .Bruce. 2005. A Review of the Empirical Literature on FDI Determinants.

Butkeyiciene J and Diaj D, 1998. International Trade in Health Services.

Central Bureau of Statistics (CBS), 2003, Population projections for Nepal, Central Bureau of Statistics, His Majesty's Government of Nepal (HMG/Nepal).

- 2004. Nepal Living Standard Survey 2003/04. HMG/Nepal

Centre for competition, investment and economic regulation (CUTS) 2003. Investment Policies that Really Attract FDI. Briefing Paper no 3/2003.

Center on Globalization and Sustainable Development (CGSD), Working Paper No. 13 , March 2004.

Chanda, Rupa, 2001. Trade in Health Services. CMH Working Paper Series. Paper No. log 4:5.

Chanda R, 2002, *Globalization of Services: India's Opportunities and Constraints,* Oxford University Press, New Delhi

Chanda R., 2001, Trade in Health Services, Working paper No 70, Indian Council for Research on International Economic Relations, New Delhi, India.

CUTS, 2003. Investment Policy in India: Performance and Perceptions. Jaipur: Consumer Unity and Trust Society.

Development, Trade and WTO: A Handbook edited by Aadiya Maatoo and Bernard Hoekman. The World Bank 2002.

DOI, 2005, Industrial Statistics, Department of Industries, HMG/Nepal

DOI, 2005, Procedural manual for Foreign Investment in Nepal , Department of Industries, HMG/Nepal

Doing Business in 2006: Creating Jobs. The World Bank

Doing Business in 2005: Removing Obstacles to Growth. The World Bank

Doing Business in 2004:Understanding Regulation. The World Bank

Dollar, David, Hallward-Driemeier, Mary, and Mengistae, Taye. Investment Climate and International Integration. World Bank Policy Research Working Paper 3323, June 2004.

Domestic regulation and service trade liberalization, 2003. Aaditya Mattoo and Pierre Sauve. The World Bank.

Donges, Juergen B. Competition for Foreign Investment in Developing Countries- The Role and Impact of FDI Incentives. 2005

Economic Survey. (various issues).His Majesty's Government of Nepal, Ministry of Finance.

FitzGerald, Valpy. Regulatory Investment Incentives. Working Paper Number 80, 2002.

Fletcher, Kevin. Tax Incentives in Cambodia, Lao PDR, and Vietnam, Prepared for the IMF Conference on Foreign Direct Investment : Opportunities and Challenges , Lao PDR and Vietnam Hanoi,, Vietnam, August 16-17, 2002.

Foreign Direct Investment in China's Provinces: Lessons for the state of Gujarat, Bajpai,.

Fung, K.C., Iizaka, Hitomi, Tong, Sarah, 2002. Foreign Direct Investment in China: Policy, Trend and Impact

Goodspeed, Timothy J. Taxation and FDI in Developed and Developing Countries, isp-aysps.gsu.edu/academics/ conferences/conf2004/Goodspeed.pdf, 2004 (?).

Görg, Holger. "Fancy a Stay at the 'Hotel California'? Foreign Direct Investment, Taxation and Firing Costs". Discussion Paper 665. Institute for the Study of Labor, Bonn, Germany (December 2002).

Gugl, Elisabeth and Zodrow, R. George. International Tax Competition and Tax Incentives in Developing Countries. 2004. http://isp-aysps.gsu.edu/academics/conferences/conf2004/Guglzodrow.pdf

Institute for Management Development (IMD) World Competitiveness Yearbook. 2004.

Japan Bank for International Cooperation, 2002. Foreign Direct Investment and Development: Where Do We Stand? JBICI Research Paper N0. 15. Tokyo.

Kokko, Ari. Globalization and FDI Incentives. 2002.

Kumar, Nagesh. Infrastructure Availablility, Foreign Direct Investment Inflows and Their Export-Orientation: A Cross Country Exploration. Research and Information System for Developing Countries, New Delhi (November 2001).

Long, Guoqiang, ???. China's Policy on FDI: Review and Evaluation.

Maskay, N.M. 2004, The interaction of Increased Trade and the Decentralization of Health Care Delivery in Nepal: A Suggestion for Reform. Yale Journal of Health Policy, Law and Ethics, Summer 2004 Vol IV, Issue 2.

Meier, Gerald M. Leading Issues in Economic Development, fifth edition, Delhi, Oxford University Press, 1990.

Miyamoto, Koji. Human Capital Formation and Foreign Direct Investment in Developing Countries. Working Paper No 211. OECD Development Centre, July 2003.

Morisset, Jacques. Does a Country Need a Promotion Agency to Attract Foreign Direct Investment? A Small Analytical Model Applied to 58 Countries, Policy Research Working Paper 3028, The World Bank, Foreign Investment Advisory Service. (2003).

Mutchnick, Ian S., David T. Stern, Cheryl A. Moyer. 2005. Trading Health services Across Borders: GATS, Markets and Caveats. *Health Affairs*, The Policy Journal of the Health Sphere.

National Planning Commission (NPC), 1992. The Eighth Plan, HMG/N.

New Business Age, 2002, Industrial Policy Vision 2020 http://www.nepalnews.com.np/contents/englishmonthly/businessage/2002/oct/cover.htm

Nunnencamp, Peter. 2002. Determinants of FDI in Developing Countries. Has Globalization Changed the Rules of the Game? http://www.uni-kiel.de/ifw/pub/kap/2002/kap1122.pdf

OECD, 2000. Main Determinants and Impacts of Foreign Direct Investment on China's Economy.

OECD Policy Brief, 2003. Attracting Investment to China.

Pant, Bhubanesh and Sigdel, Bam Dev. "Attracting Foreign Direct Investment: Experiences and Challenges". NRB Working Paper, NRB/wp/1. (April 26, 2004).

Rahman, Bangladesh; The potential Investment Destination of South Asia bangladoot.org

Smith, Richard D. "Foreign direct investment and trade in health services: A review of the literature" *Social Science & Medicine* **59** (2004) 2313-2323.

Thanadsillapakul ,Lawan, The Investment Regime in ASEAN Countries. http://www.thailawforum.com/articles/lawaninvestment4.html)

Trade Capacity Building in the Services Sector, A Resource Guide. Submitted by Nathan Associates Inc. TCB Project to USAID/Washington, May 2004.

Trade Policy Review Singapore June 2004 http://www.wto.org/english/tratop_e/tpr_e/s130-3_e.doc

2005 -Investment Climate-Thailand, http://www.state.gov/e/eb/ifd/2005/42188.htm

Trade Policy Review Sri Lanka 1995, WTO website, http://www.wto.org/english/tratop_e/tpr_e/tp17_e.htm

Trade Policy Review of Singapore May 1996. (http://www.wto.org/english/tratop_e/tpr_e/tp33_e.htm)

Trade Policy Review March 2000.. http://www.wto.org/english/tratop_e/tpr_e/tp130_e.htm.)

Trade Policy Review of Thailand, 1999. (http://www.wto.org/english/tratop_e/tpr_e/tp122_e.htm).

Trade Policy Review January 1996, (http://www.wto.org/english/tratop_e/tpr_e/tp22_e.htm).

United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP), 2000. Implications of General Agreement on Trade in Services (GATS) for the Asia-PAcific Economies, Studies in Trade and Investment No. 37.

United Nations Conference on Trade and Development (UNCTAD), 2005. World Investment Report. Transnational Corporations and the Internationalization of R & D.

UNCTAD, 2004. World Investment Report, The Shift Towards Services.

UNCTAD, 1998. World Investment Report. New York, United Nations Publication.

UNCTAD, 1996.Incentives and Foreign Direct Investment. New York, United Nations Publication.

UNCTC, 1992. The Determinants of Foreign Direct Investment: A Survey of Evidence. New York, United Nations Publication.

UNCTAD-ICC. An investment guide to Nepal. Opportunities and Conditions. United Nations, New York and Geneva, 2003.

Wells, Louis T. and Wint, Alvin G. Marketing a country, Promotion as a tool for attracting Foreign Investment, Foreign Investment Advisory Service.

World Development Indicators, 2005. The World Bank..

World Development Report, Making Services Work for the Poor. (2004). The World Bank.

World Development Report A Better Investment Climate for Everyone. (2005)

World Trade Organization. WTO homepage. http://www.wto.org

____. "Report of the Working Party on the Accession of the Kingdom of Nepal to the World Trade Organization". **WT/ACC/NPL/16.** (28 August 2003a)

____. "Report of the Working Party on the Accession of the Kingdom of Nepal to the World Trade Organization: Addendum – Part II – Schedule of Specific Commitments in Services List of Article II MFN Exemptions". **WT/ACC/NPL/16/Add.2.** (28 August 2003b)WT/ACC/NPL/, 2003, Report on the Working Party on the Accession of the Kingdom of Nepal, World Trade Organization.

World Trade Organization. "WTO membership rises to 147". WTO News: 2004 Press Release / 356. (23 April 2004).

APPENDICES

Appendix 1: Background Information on the Concept of GATS of the World Trade Organization and its Schedule format

The General Agreement on Trade in Services (GATS) of the WTO, is the first ever set of multilaterally, legally enforceable rules, covering international trade in services. It was negotiated in the Uruguay Round of the then General Agreement on Trade and Tariff (GATT). Like the agreement on goods, GATS operate on three levels: the main text containing general principles and obligations; annexes dealing with rules for specific sectors; and individual countries specific commitments to provide access to their markets. Unlike in goods, GATS has a fourth special element: lists showing where countries are temporarily not applying the "most-favored-nation" principle of non-discrimination. These commitments, like tariff schedules under GATT, are an integral part of the agreement. So are the temporary withdrawals of the most-favored nation treatment.

The basic principles of GATS are:

- All services are covered by GATS
- Most favored nation treatment applies to all services, except the one-off temporary exemptions
- National treatment applies in the areas where commitments are made
- Transparency in regulations, inquiry points
- Regulations have to be objective and reasonable
- International payments: normally unrestricted
- Individual countries' commitments: negotiated and bound
- Progressive liberalization: through further negotiations

In regard to the scope and coverage of GATS, the agreement applies to all trade in services by WTO members. The exception is the services supplied in the exercise of governmental authority such as central banking and social security, which are neither supplied on a commercial basis nor in competition with other service suppliers. The GATS schedule largely follows a classification based on the United Nations Central Product Classification system, which identifies 11 basic service sectors plus a twelfth category for miscellaneous service. These are:

- Business (including professional and computer) services
- Communication services
- Construction and related engineering services
- Distribution services
- Educational services
- Environmental services
- Financial (insurance and banking) services
- Health-related and social services
- Tourism and travel-related services

- Recreational, cultural and sporting services
- Transport services and
- Other services not included elsewhere

This WTO schedule format for service sector commitments and accurate submission of factual information is reviewed and is based on WTO (1996). It should be noted that in contrast to commitments with regard to goods, services are a bit complex as there are two sorts of provisions under the GATS: the first are general obligations, some of which apply to all sectors (e.g. MFN, transparency, etc.); while the second are specific commitments which are negotiated undertakings specific to each member. These commitments can further be broken down into horizontal and specific commitments. Horizontal commitments affect all sectors, and sub-sectors, equally; this is usually at the top of the Schedule of Service Sector Commitments.[27] Specific commitments to open markets, on the other hand, are specific to the sector and are provided for market access (e.g. whether there are restrictions to foreign ownership) and national treatment[28] (e.g. whether some rights granted to local companies will not be granted to foreign companies) which are generally put forward with two separate columns. [29,30]

In the columns for market access and national treatment, the various categories under each sub-sector of a particular sector, are listed. So, in the case of FSS, the first

---

[27] The discussion will be consistent with the schedule of the selected SAARC member countries' FSS is provided on the Internet web home page of Nepal Rastra Bank at www.nrb.org.np as the first and second appendix for market access and national treatment respectively for the interested to look into its details.

[28] The GATS states that "in the sectors covered by its schedule, and subject to any conditions and qualifications set out in the schedule" each member shall give treatment to foreign service and service suppliers treatment, in measures affecting supply of services, no less favorable than it gives its own service and suppliers.

[29] For ease of understanding, the general [skeleton] table format for market access, which is also true for national treatment, is presented below in tabular form:

Financial Service Sector – limitations to market access	
All insurance and insurance-related services	1) Cross-border supply
	2) Consumption abroad
	3) Commercial presence
	4) Presence of natural persons
Banking and other Financial Services (excluding insurance)	1) Cross-border supply
	2) Consumption abroad
	3) Commercial presence
	4) Presence of natural persons
Other	1) Cross-border supply
	2) Consumption abroad
	3) Commercial presence
	4) Presence of natural persons

This is likewise demonstrated in the example of Nepal FSS commitments, as shown in the attached appendix.

[30] An example from WTO (1998) will clarify this "if a government commits itself to allow foreign banks to operate in its domestic market, which is a market access commitment. And if the government limits the number of licenses it will issue, then that is a market access limitation. If it also says foreign banks are allowed one branch while domestic banks are allowed numerous branches, that is an exception to the national treatment principle."

column includes the sub-sectors of “All insurance and insurance-related services”, “Banking and other Financial Services (excluding insurance)” as well as the “Other” sub-sector along with the different categories described earlier. In the second column information relating to market access are included for each category based on the four modes of supply by which any service can be supplied and are: *Cross border supply* (i.e. the service supplier is typically not present within the territory of the government where the service is delivered with some examples being international transport, the supply of a service through telecommunications or mail, and other such services embodied in exported goods [e.g. a computer diskette, or drawings]); *Consumption abroad* (i.e. this mode of supply is often referred to as “movement of consumers” whose essential feature is that the service is delivered outside the territory of the government concerned and typically includes crossing for the border of the consumer as, for example, in tourism services[31]); *Commercial presence* (i.e. this mode covers not only the presence of juridical persons in the strict legal sense, but also that of legal entities which share some of the same characteristics includes, *inter alia*, corporations, joint ventures, partnerships, representative offices and branches); *Presence of natural persons* (i.e. this mode covers natural persons who are themselves service suppliers, as well as natural persons, who are employees of service suppliers). The four modes of supply are simply stated as Mode 1, 2, 3 and 4 for cross border supply, consumption abroad, commercial presence and presence of natural persons respectively.

Commitments are recorded in the WTO schedule format in the table for market access and national treatment, through a number of ways. First, as mentioned earlier there are horizontal commitments which apply to trade in services in all scheduled services sectors unless otherwise specified; it is in effect a binding either of measures which constitutes a limitation on market access or national treatment, or of a situation in which there are no such limitations. Second, there are sector specific commitments which apply to trade in services in a particular sector; it is in the context of such a commitment, when a measure is maintained which is contrary to GATS Article XVI or XVII, it must be entered as a limitation in the appropriate column (either market access or national treatment for the relevant sector and modes of supply). Third are recordings of the various levels of commitments; their presentations are extremely important and have to be very precise since the terms used create legally binding commitments indicating the presence or absence of limitations to market access and national treatment. Depending on the extent to which a member has limited market access and national treatment, for each commitment with respect to each mode of supply, four cases each for market access and national treatment, can be foreseen:

- *Full commitment* – Members do not seek in any way to limit market access or national treatment in a given sector and mode of supply through measures inconsistent with GATS Article XVI and XVII. In this situation, the appropriate column is marked with NONE. However, any relevant limitations listed in the horizontal section of the schedule will still apply.

[31] Although activities such as ship repair abroad, where only the property of the consumer moves, or is situated abroad, are also covered.

- *Commitment with limitations* – Where market access or treatment limitations are inscribed, the member must describe in the appropriate column the measure maintained which are inconsistent with GATS Articles XVI or XVII. The entry should describe each measure concisely, indicating the elements which make it inconsistent with GATS Articles XVI or XVII. Further, in some cases, members may choose to partially bind measures affecting a given category of supplier. This may be achieved through an indication in the horizontal section of a schedule with the corresponding sectoral entry under the relevant mode of supply (i.e. it may thus read "Unbound except as indicated in the horizontal section").

- *No commitment* – In this case, the Member remains free in a given sector and mode of supply to introduce or maintain measures inconsistent with market access or national treatment. In this situation, the Member must record in the appropriate column the word: UNBOUND. This case is only relevant where a commitment has been made in a sector with respect to at least one mode of supply.[32]

- *No commitment technically feasible* – In some situations, a particular mode of supply may not be technically feasible. An example might be the cross-border supply of hair-dressing services. In these cases, the term UNBOUND* should be used. The asterix should refer to a footnote which states "Unbound due to lack of technical feasibility."

It is in "Commitments with limitations" that acceding government may limit market access horizontally or to any specific service sector. Such limitations for market access includes, according to both Article XVI and XVII of GATS: (a) Limitations on the number of service suppliers (e.g. ceilings on the total number of banks); (b) Limitations on the total value of transactions on assets (e.g. foreign bank subsidiaries limited to X per cent of total domestic assets of all banks); (c) Limitations on the total number of service operations or on the total quantity of service output (e.g. restrictions on broadcasting time available for foreign firms); (d) Limitations on the total number of natural persons (in particular non-nationals) that may be employed in the sector (or the share of wages paid to foreign labor); (e) Restrictions on, or requirements of, specific types of legal entity through which that service may be supplied (e.g. commercial presence exclude representative offices, foreign companies required to establish subsidiaries, commercial presence must take the form of a partnership); (f) Limitations on the participation of foreign capital. In addition to these limitations it is suggested that clear reference will also have to be made to the relevant laws or regulations.

For completeness an additional column is usually provided for additional commitments with respect to measures affecting trade in services not subject to scheduling under market access or national treatment. Thus, additional treatments are expressed in the form of undertakings, not limitations. In the schedule, the additional comments column would only include entries where specific commitments are being undertaken, and need not include those modes of supply where there are not commitments undertaken.

[32] Where all modes of supply are "unbound", and no additional commitments have been undertaken in the sector, the sector should not appear on the schedule.

References

World Trade Organization. web page www.wto.org

____. Understanding the WTO. 4th edition. (October 2005).

____. "Guidelines for the Scheduling of Specific commitments under the General Agreement on Trade in Services". **S/L/92 (**28 March 2001).

____. “General Agreement on Trade in Services: Annex 1B.” (1995).

Appendix 2: Background Information on the Pros and Cons of Providing Health Services Under Each Mode of the GATS

Using the GATS definitions, trade in health services can be supplied in four different ways: 1) cross-border delivery of health service supplies that are not present in the domestic economy through telemedicine or telediagnosis; 2) consumption of health services abroad when domestic consumers travel to a foreign country to receive health services; 3) commercial presence, such as a foreign service provider establishing a joint venture health institution in the domestic economy; and 4) movement of people such, such as health care professionals between countries. There are both benefits and costs of these trade mechanisms (Chanda, 2002, 159 – 161):

The potential benefit of the first mechanism (e.g. telemedicine) are, among other things, that it allows health services to cater to remote areas, helps alleviate human resource constraints and provides cost-effective surveillance of disease. The potential cost is the reallocation of resources from rural and primary healthcare to specialized services which cater to the affluent few, since they are able to afford the necessary technology.

The potential benefit of the second mechanism (i.e., consumption of healthcare services abroad) is its potential to improve the healthcare system by generating additional resources for investment in healthcare. It may also increase the level of foreign exchange: For example, when individuals travel abroad to consume a health service, they contribute to the local economy and bring in foreign currency. The potential cost is similar to that noted above for the first mechanism: It may create a dual market structure with higher quality care going to the affluent and much lower quality care going to the poor. A related concern is the crowing out of the population from the higher standard centers at the expense of the public healthcare system.

The potential benefit of the third mechanism (i.e., foreign commercial ventures) is that it helps generate additional investment in the health sector, upgrade health care infrastructure, facilitate employment generation, and provide expensive and specialized medical services. Again, the potential cost may be growing inequality to access and a two tiered health care system. This two-tiered system results from an internal "brain drain," as the foreign commercial ventures encourage health professionals to move from the public to the private sector.

The potential benefit of the fourth mechanism (i.e., movement of healthcare professionals) is that it may promote the exchange of clinical knowledge among professionals and there fore upgrade the skills and standards in the two countries. The potential costs may be its detrimental effect on equity, quality, and availability of health care services if the health care professionals move on a permanent basis, thereby leading to a shortage of highly trained personnel.

References

Chanda, Rupa. Trade in Health Services, *Bulletin of the World Health Organization*. **80** (2002) 158 – 160.

Annex 3: FDI Liberalization, with Focus on the Service Sector, on Seven Selected Countries

1. Bangladesh

Background: Bangladesh, up to the early 1980's, was a closed economy characterized by political uncertainty with the government having nationalized all large and medium industries. This situation changed when Bangladesh initiated major industrial policy reforms in 1982 and further liberalization of FDI policy in 1986, the later occurred with the assistance of the IMF under the Structural Adjustment Facility (SAF). The pace of reform gathered momentum after the restoration of democracy in 1991 and the recent adoption of policies which aims to further simplify the import regime to respond to both globalization and to WTO related commitments.[33] Bangladesh automatically became the member of WTO in 1995 being a GATT member. However, Bangladesh has scheduled the least number of the sub-sectors in the GATS commitments among the seven countries.

Procedures of FDI: There is a clear procedure for FDI in Bangladesh with the Bangladesh Board of Investment (BOI) having been set up as a one-stop shop for all investors to allow them to register for all industrial projects outside the export processing zones (EPZ).[34] The BOI assists the investors on taxation, land acquisition, utility connection, and incorporation related matters. Further, the BOI facilitates coordination with the Bangladesh Export Processing Zones Authority (BEPZA) and the Ministry of Investment (BOI) and the Ministry of Finance. The BOI does not make a clear differentiation between manufacturing and service FDI.

Incentives for FDI: Incentives for investors[35] - which Bangladesh hails as the most liberal FDI environment in Asia - include 100 per cent ownership in most sectors; tax holidays; reduced import duties on capital machinery and spares; duty-free imports for 100 percent exporters; and tax exemptions on technology remittance fees, on interest on foreign loans, and on capital gains by portfolio investors. Other liberalized measures include fast track issuance of work permits for foreign nationals, reduced approval time for new investment; relaxation of the Foreign Exchange Control Act, increased tariff rebates with

---

[33] Bangladesh also started to privatize public sector enterprises though the success of the privatization has been limited (Rahman, 2001).

[34] The EPZs offer tax rebated, a relatively secure power source, duty free import of capital machinery, warehouse facilities and other benefits to 100 percent export-oriented industries. The primary objective of an EPZ is to provide special areas where potential investors would find a congenial investment climate, free from cumbersome time consuming local bureaucratic procedures. All of these zones, which provide necessary fiscal and infrastructure facilities for export-oriented enterprises, offer investors fully developed and serviced industrial plots and factory buildings for rental purposes.

[35] There are no distinctions between foreign and domestic private investors regarding investment incentives or export or import policies.

special concessions for the imported capital machinery for export-oriented industries, protection of industrial goods through tariff rationalization, simplification of the raw material import policy and reduction of tariff rates (BOI, 2003). The summary of the various incentives given by the BOI are given in the third appendix. However, there are no clear differentiation between incentives for manufacturing and service FDI.

Health Services: Bangladesh has not made any GATS commitments.

2. India

Background: The reform process in 1991 has deregulated the economy[36] and stimulated domestic and foreign investments, taking India into the forefront of investment destinations. The Government of India (GOI), keen to promote investment in the country has simplified and rationalised polices, procedures and regulatory aspects,[37] foreign investment is welcome in almost all sectors, except those of strategic concern (for instance, defense and atomic energy). India is a founding member of WTO and has scheduled 33 sub-sectors among the possible 161 sub-sectors under the GATS.[38]

Procedures of FDI[39]: The Indian authorities have established a number of bodies to facilitate FDI flow. The principal body is a foreign investment promotion board (FIPB) which has been constituted to promote inflows of FDI and to provide appropriate institutional arrangements, transparent procedures and guidelines for investment promotion and to consider and approve /recommend proposals for foreign investment. Further, GOI has set up the Foreign Investment Implementation Authority (FIIA) to facilitate the process of translating FDI approvals into implementation with the Secretariat for Industrial Assistance (SIA) set up in the Department of Industrial Policy and Promotion in the Ministry of Commerce & Industry; to provide a single window service for entrepreneurial assistance.[40] In order to give further impetus to facilitation and

---

[36] Since the initiation of the economic liberalization process in 1991, sectors such as automobiles, chemicals, food processing, oil & natural gas, petrochemicals, power, services, and telecommunications have attracted considerable investments.

[37] The industrial policy reforms have eliminated the industrial licensing requirements except for certain select sectors, removed restrictions on investment and expansion and facilitated easy access to foreign technology and direct investment. Foreign investment policy has been liberalized considerably as many constraints were removed, and approval is now given automatically for an increasing range of industries. Moreover, controls on foreign exchange transactions, and on technology and royalty payments were removed to facilitate foreign investor's operations. Constraints on foreign equity participation have been gradually relaxed; leading to an increase in both the majority foreign owned joint ventures and in wholly foreign owned subsidiaries (CUTS, 2003).

[38] The extent of these commitments vary across sub-sectors, with certain restrictions on market access and national treatment for different modes of service supply, namely cross-border movement, consumption abroad, commercial presence and presence of natural persons. The commitments undertaken were broadly in line with existing policy frameworks, and in some cases applied policy may be more liberal than the binding commitments (UNESCAP, 2000).

[39] The information regarding the procedures and incentives are taken mostly from the official website of Ministry of commerce and Industry, Department of Industry Policy and Promotion www.dipp.nic.in.

[40] This takes the form of investor facilitation, receiving and processing all applications which require government approval, conveying government decisions on applications filed, assisting entrepreneurs and investors in setting up projects and in monitoring implementation of projects. It also notifies all government

monitoring of investment, as well as for better coordination of infrastructure requirements for industry, a new institutional set-up known as the' Investment Promotion and Infrastructure Development Cell' has been created (www.dipp.nic.in). The FIPB does not make a clear differentiation between manufacturing and service FDI.

Incentives for FDI: Most sectors of the Indian economy are now at least partially open to foreign investment, with certain exceptions. In July 1991, India took a major deregulation measure abandoning the industrial licensing system except in 15 critical industries. Foreign firms are permitted to possess a major shareholding, and foreign investment up to a maximum of 51 percent equity in 35 high priority industries receives automatic approval. The new investment policy also lists more incentives to attract FDI from non-resident (NRIs). Indians and overseas corporate bodies (OCBs) primarily operated by NRIs, such as 100 percent share in many areas and full repatriation of profit. In addition, various fiscal, financial and infrastructural facilities are given to the foreign investors which are provided in the third appendix. However, there are no clear differentiation between incentives for manufacturing and service FDI.

Health Services: India has made commitments in this area. Among the four sub-sectors of HRSS, India has scheduled only the hospital services. However, India has made only partial commitment in mode 3 i.e. commercial presence, only through incorporation with a foreign equity ceiling of 51 percent. All other remaining modes are "unbound".

3. Malaysia

Background: Malaysia's industrial policy during the seventies and the eighties was focused on promoting exporting industries. As a result, export performance was used as the main conditionality for foreign equity ownership.[41] Malaysia became the member of WTO on 1995 and committed over 60 subsectors under the GATS. However, many services sector of the national economy remains highly protected.[42] Consequently, foreign firms in Malaysia have been confined to export industries. Only in 1998 were such restrictions lifted in order to revive the sluggish FDI inflows.

Procedure of FDI: Applications for manufacturing licenses are to be submitted to the Malaysian Industrial Development Authority (MIDA), an agency in charge of the promotion and coordination of industrial development in Malaysia[43].. The MIDA does

---

policy decisions relating to investment and technology, and collects and publishes monthly production data for select industry groups.

[41] Basically, the greater the percentage of the products exported, the higher the foreign equity share. For example, if the project exports more than 80% of the products, 100% foreign ownership is allowed.

[42] For example, under the WTO Basic Telecommunications Agreement, Malaysia made limited commitments on most basic telecommunications services and made partial commitments in other sector such Professional services; legal services; financial services etc.

[43] The information is taken from the official website of Malaysian Development Authority (www.mida.gov.my)The government's guidelines for approval of industrial projects in Malaysia are based on the Capital Investment per Employee (C/E) Ratio. Projects with a C/E Ratio of less than RM55, 000 are categorized as labor-intensive and thus will not qualify for a manufacturing license or for tax incentives. Nevertheless, a project will be exempted from the above guidelines if it fulfils other specific criteria.

not make a clear differentiation between manufacturing and service FDI, and leans more towards manufacturing FDI.

Incentives for FDI: Malaysia encourages foreign direct investment, particularly in export-oriented manufacturing and high-technology industries, but retains considerable discretionary authority over individual investments [44]. Corporations in manufacturing, agriculture, tourism and various other activities may receive a 'pioneer' status and various tax holidays, exemptions and reduced import duty and VAT are given to attract the FDI. Likewise, infrastructural facilities such as Free Industrial Zones and other allowances are also provided. The different incentives provided by the investment authority are given in the third appendix below. However, there are no clear differentiation between incentives for manufacturing and service FDI.

Health Services: Malaysia has made commitments in this area. Malaysia has scheduled two sub-sectors namely medical specialty services and private hospital services. Regarding mode wise commitments, there are no restrictions in mode 1 and mode in both these services. In mode 3, private hospital services should fulfill the economic needs test and through the locally incorporated joint-venture corporation with a minimum of 100 beds. Also, medical specialty services may be supplied only by a natural person. Mode 4 is generally unbound except for categories of natural persons referred to under market access.

4. People's Republic of China

Background: The People's Republic of China (PRC) maintains its position as one of the world's top destination for FDI .[45] Since late 1970s, China has gradually opened its economy for foreign businesses and has attracted large amount of direct foreign investment (Fung et al, 2002). China's FDI policy is complicated. For the last 25 years, China has aggressively shaped a relatively complete range of laws and regulations governing foreign investment (Long, ??). China's accession to the WTO in December 11, 2001 has already brought about major advances in FDI policy. In addition to the removal of trade-related investment measures, China is also opening up its services sectors, including the financial sector. Existing foreign-invested enterprises are now able to distribute their products in China and engage more widely in foreign trade.[46]

Procedure of FDI: In accordance with the existing laws of China, the establishment of enterprises with foreign investment is subject to project-by-project examination, approval and registration by the government. China does not make a clear differentiation between manufacturing and service FDI.

[44] Taken from the Office of the United States Trade Representative website (www.ustr.gov).

[45] Taken from www.state.gov. China has been the largest recipient of FDI among developing countries since early nineties and in recent years account for about 1/3 of FDI flows to developing countries (Fung et al 2002).

[46] These changes will provide opportunities for enterprises based in OECD member countries to play a bigger role in making direct investments in China.

Incentives for FDI: To encourage foreign investment, FDI policy in China gives preferential treatment to Foreign Invested Enterprises compared to domestic enterprises including low tax rates, favorable financial services from domestic and financial institutions. China has made significant progress in providing a business environment conducive to FDI since the major shift to economic reform in 1978. A closed economic system has been rapidly opened to trade and investment with major economic institutions being replaced or transformed via lengthy reform that will bear fruit in the future (OECD, 2003). Thus, China receives about 10 times FDI as India which is attributed to greater political stability, efficient bureaucracy and more investor friendly climate. The different incentives provided are given in the third appendix below. However, there are no clear differentiation between incentives for manufacturing and service FDI.

Health Services: PRC has not made commitments in this area.

5. Singapore

Background: Singapore's continuing rapid economic development over the last decade owes much to its open trade régime, prudent, clearly directed economic management and its position in the centre of a dynamic regional market. Political stability and a well-developed infrastructure combine with very high rates of savings and investment and attractive investment incentives to make the economy one of the strongest in the world (Trade Policy May 1996. (http://www.wto.org/english/tratop_e/tpr_e/tp33_e.htm). Singapore has a highly developed services sector with about 65% of contribution to GDP. Singapore has scheduled seven services sector under the GATS except Distribution, Environment, Financial and Other services.[47] However, Singapore has made commitments in health care services viz. medical services, dental services and veterinary services.

Procedures for FDI: Singapore has a liberal foreign investment climate with there being no screening of foreign investment in Singapore. However, every business in the country must be registered under both the Business Registration Act and the Company Act, which are administered by the Ministry of Finance. The Registrar has primary authority over the registration of a foreign company. The Department of Trade, the Economic Development Board (EDB) and the Trade Development Board (TDB) may also have jurisdiction in relation to the area of business in which the company wishes to operate. Generally, the Singapore government actively encourages foreign investment and treats foreign investors the same as local ones. With the exception of national security and certain industries, there is no restriction on foreign ownership of Singapore corporations, and there is no screening of foreign investment in Singapore as mentioned (The Investment Regime in ASEAN Countries, Dr. Lawan Thanadsillapakul,...

[47] The basic objective of Singapore's GATS Schedule of Commitments was to bind existing levels of accessibility in service activities where commitments had already been made, subject to relevant domestic regulations and licensing requirements (UNESCAP, 2000).

http://www.thailawforum.com/articles/lawaninvestment4.html). Singapore does not make a clear differentiation between manufacturing and service FDI.

Incentives for FDI: FDI is liberalized with regard to manufacturing activities. In order to attract the FDI, Singapore offers various incentives which are provided under the two Acts namely, the Economic Expansion Act and the Income Tax Act. The incentives usually include concessional corporate tax rates of between 5% and 15% (the normal rate is 22%) or corporate income tax exemptions, depending on the scheme. Non-tax incentives include grants for certain activities (at present especially those relating to promoted high-value-added sectors), training, and R&D. In addition, incentives are provided for investors in several services, including financial services, tourism, media services, and telecommunications. The summary of the incentives provided by the EDB are given in the third appendix. However, there are no clear differentiation between incentives for manufacturing and service FDI.

Health Services: Singapore has made commitments in this area. Singapore has scheduled medical services, dental services and veterinary services under the health services. Mode-wise, Singapore has no restrictions on modes 1, 2 and 3 with the exception in medical services in mode 3 where, the number of new foreign doctors registered each year may be limited depending on the total supply of doctors. Mode 4 is unbound except indicated in the horizontal section.

6. Sri Lanka

Background: Until the late 1970s, Sri Lanka's economic development centered on import-substituting activities performed mainly by state-owned firms. Encouraged by strong export-driven growth in east and south-east Asian economies, economic and trade reforms were initiated in 1977 with Sri Lanka having opened its service sector to foreign investment the following year.[48] Their initial focus was on export expansion in manufacturing, particularly clothing, although emphasis has shifted recently to broader-based liberalization (Trade Policy Review Sri Lanka 1995, WTO website, http://www.wto.org/english/tratop_e/tpr_e/tp17_e.htm). At the same time, Sri Lanka liberalized its FDI policies and offered various incentives to attract FDI in the export oriented industries followed by second round of reforms in 1989 under the IMF's SAF program. Sri Lanka has accepted Article VIII of the IMF on March 1994 and has liberalized exchange controls on current account transactions.

---

[48] Foreign ownership of 100 percent of equity is allowed in a range of service sectors such as banking, insurance, telecommunications, tourism, stock brokerage, the construction of residential buildings and roads, the supply of water, mass transportation, production and distribution of energy, professional services and the establishment of liaison offices or local branches of foreign companies. These services are regulated and subject to approval by various government agencies. The screening mechanism is non-discriminatory and, for the most part, routine.

Procedures of FDI: All FDI is subject to government approval in Sri Lanka. However, approval, in general, is handled by the Board of Investment (BOI).[49] The BOI is an autonomous statutory agency operating directly under the President, and is the primary government authority responsible for foreign investment. It is a "one-stop" window for foreign investors whose services include: approving projects, granting licenses, establishing eligibility for tax incentives, and assisting in procurement. (Trade Policy Review, March 5, 2004 http://www.wto.org/english/tratop_e/tpr_e/s128-2_e.doc). In certain sectors FDI may not be approved by the BOI; approval in these cases is granted only after the foreign investment proposal has been evaluated by other government agencies. Proposals might have to be evaluated by several ministries/agencies, which need to grant a "special approval"; the percentage of equity participation is decided on a case by case basis. In other sectors, the BOI may approve FDI up to a certain limit. The BOI does not make a clear differentiation between manufacturing and service FDI.

Incentives for FDI: In Sri Lanka one hundred percent foreign investment is allowed in most manufacturing and services sectors. The BOI offers a range of incentives to both local and foreign investors. To qualify for Board of Investment (BOI) incentives, investors need to meet minimum investment and minimum export requirements. In general, the treatment given to foreign investors is non-discriminatory[50] . Some of the major incentives offered by the BOI are given in the third appendix. However, there are no clear differentiation between incentives for manufacturing and service FDI.

Health Services: Sri Lanka has not made commitments in this area.

7. Thailand

Background: Thailand's economic policies have evolved over the past decades with an initial emphasis on import-substitution from the mid-1970s to a switch to export orientation. Since the early 1990s, Thailand has sought to move its economy in an outward-oriented direction, towards a more neutral balance of incentives. Besides trade liberalization, an important element in this has been a redirection of the investment incentives offered by the Board of Investment (BOI) away from export promotion to regional development (Trade Policy Review January 1996, http://www.wto.org/english/tratop_e/tpr_e/tp22_e.htm). Thailand became the member of WTO in 1995 and at the end of the Uruguay Round submitted the schedule of specific commitments to liberalize 10 service sectors and 95 sub sectors.[51]

---

[49] The main laws regulating foreign investment in Sri Lanka are the Board of Investment (BOI) of Sri Lanka Law No.4 of 1978 as amended (in 1980, 1983, 1992, and 2002) and its implementing regulation, and the Exchange Control Act, which, *inter alia,* stipulates foreign equity limitations in various sectors.

[50] Taken from the Office of the United States Trade Representative website (www.ustr.gov).

[51] With regard to commitments, Thailand has made full commitments in mode 2 (consumption abroad) and made no commitments in mode 1 (cross border). For the remaining modes, Thailand has made commitments with certain conditions and limitations. Limitations on the commercial presence mode of supply are mainly on foreign ownership or foreign equity participation in many services.

Procedures for FDI: Thailand encourages FDI through the BOI. Both non-tax and tax incentives, such as tax holidays and waivers of duties on imported capital goods, are offered as part of general investment policies. However, the BOI in Thailand does not make a clear differentiation between manufacturing and service FDI.

Incentives for FDI: The BOI recognizes a need to remove impediments to investments rather than relying on widely used tax incentives. On 1 August 2000, therefore, the BOI made various changes to its investment incentive scheme; the changes involved, *inter alia,* streamlining various tax-based incentives intended to attract inward FDI. On the other hand, the BOI appears to be taking a more proactive approach to industrial policy and the pursuit of competitiveness, with measures targeted at certain industries, such as agri-industry, automobiles, textiles, electronics, and high-valued services (Trade Policy Review, 2003). Some of the major incentives provided by BOI are given in the third appendix. However, there are no clear differentiation between incentives for manufacturing and service FDI.

Health Services: Thailand has not made commitments in this area.

Annex 4.1 Background on Nepal

The Kingdom of Nepal, with a population of about 25 million (CBS, 2003) and an area of 147141 sq km., is a landlocked country located between the two populous nations- India and China. Nepal is one of the 49 countries designated as "least developed" countries (LDC) by the United Nations based on low national income (per capita GDP under $900 as a threshold for joining the list), weak human assets (a composite index based on health, nutrition and education indicators) and high economic vulnerability criteria.[52] Nepal's GDP amounted to US dollar 6407 million in 2003/04 of which the service sector contributed 39 percent (WDR, 2005) and the external sector was 35.26 percent of GDP respectively (MOF, 2005). Further, domestic saving as a percentage of total investment came to around 45 percent creating a huge saving investment gap financed mainly from external borrowing.[53] To accelerate economic growth and development Nepal has embarked on economic liberalization – this process had picked-up speed only after the restoration of the multi-party democracy and the country's subsequent Eighth Development Plan (1992-97)[54] saliently reflected in acceptance of Article VIII of the AoA of the IMF on May 30, 1994, for an open current account.

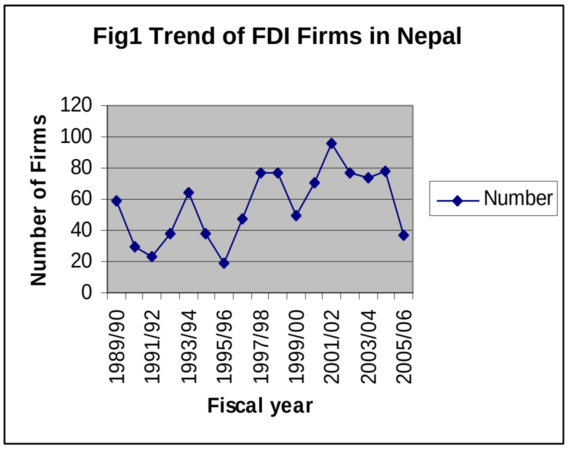
As part of its drive to become more integrated with the world economy and continue the process of economic liberalization, Nepal had also initiated the membership process in the General Agreement on Trade and Tariffs (GATT) in 1989. In response to this Nepal was granted the observer status in 1993 and finally acceded to the predecessor of GATT, the WTO, on April 23, 2004; Nepal is the 147th member and first LDC country to accede to the international trading organization through the full membership route (WTO, 2004). During the accession process, Nepal had commitment to open its market with some conditions in 70 WTO classified sub-sectors (MOF, 2004), with majority of those being for having foreign investment.[55]

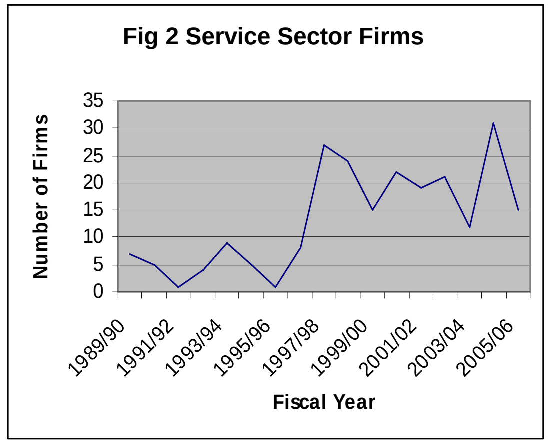
This commitment had, in a way, simply cemented Nepal's existing situation since foreign investment inflows had started in Nepal even before the 1990s. There were about five dozen industries employing about 11 thousand people in 1989/90. With more liberal and welcome policies to attract foreign investment, the years following 1990 witnessed significant increase in FDI in Nepal. By 2005/06, 955 industries were registered in the Department of Industry with foreign investment worth 26 billion and employment to about 99 thousand people.[56]

---

[52] See press release, U.N. Conference on Trade and Development, Least Developed Countries at a Glance (June 18, 2002) http://www.unctad.org/Templates/webflyer.asp?docid=2929&intItemID=1634&lang=1.
[53] The S/GDP, I/GDP and S-I/GDP ratio were 12.3, 26.1 and 13.8 respectively in 2004/05 (MOF, 2005). This kind of situation for a long period of time has resulted in an external debt of around 31 percent of the gross national income (World Bank, 2005)
[54] The formal endeavor to economic liberalization in Nepal had started in 1985.
[55] These are commercial, communication, construction and engineering, distribution, education, environment, financial, health, tourism, transportation, entertainment etc.
[56] Some of these industries had been closed or are presently non-operational.

Based on recent foreign investment statistics of His Majesty's Government of Nepal (HMG/N), the service sector firms constituted 12 percent of the total number of firms in the country. By 2005/06 there were altogether 226 firms in the service sector with employment capacity of 15637 persons. This was about 24 percent of the total number of firms. The years 2004/05 and 2005/06 were outstanding years and recorded around 40 percent of the total foreign investment firms in the service sector while in terms of investment amount and employment generation, it accounted over half and two third share of the total respectively.





Source: DOI, 2005

Annex 4.2

Constitution of the One-Window Committee

The One Window Committee was constituted under the Industrial Enterprises Act 1992 under Section 17. This act was later amended as Industrial Enterprises Act 1997**.**

The Section of the Act related to One Window Committee is presented below

17. Constitution of the One-Window Committee:

1) His Majesty's Government shall, for the purpose of making available the facilities and concessions to be enjoyed by any industry under this Act in time from a single place, constitute a One-Window Committee consisting of the following:

a) The Director-General, Department of Industries	Coordinator
b) The Director-General, Department of Customs	Member
c) The Director-General, Department of Excise Duty	Member
d) The Director-General, Tax Department	Member
e) The Director-General, Sales Tax Department	Member
f) The Director-General, Department of Commerce	Member
g) The Chief Controller, Nepal Rastra Bank	Member
h) Representative, Federation of Nepalese Chambers of Commerce and Industry	Member
i) One expert in the field of industry and commerce as designated by His Majesty's Government or one representative from the Federation	Member

2) His Majesty's Government may, by notification published in the Nepal Gazette, make alterations or changes in the members of the Committee.
3) The Committee may, if it deems necessary, invite any national or foreign expert or consultant to participate in the meetings of the Committee as an observer.
4) The procedures relating to the meetings of the committee shall be as determined by the Committee.

18. Function, Duties and Powers of the Committee:
1) The functions, duties and powers of the committee shall be as follows:

a) To make necessary decisions for making available the facilities and concessions to be enjoyed by any industry under this Act.
b) To perform such functions as may be delegated by the Board under its functions, duties and powers.
@b1) To make recommendations as may be required for making time-bound provisions on making available infrastructural services such as electricity, water, means of telecommunications, land, road, and so on required for the industries.
c) Other functions, duties and powers of the Committee shall be as prescribed.

2) Any decision made by the Committee in pursuance with clause (a) of sub-section (1) above, shall be required be implemented by the concerned body.
3) *The Committee may, as required, delegate some of its powers to the subcommittee constituted under sub-section (4): Provided that the powers specified in clause (b) of sub-section (1) of section (18) will not be delegated.
4) *The Committee may constitute sub-committees as may be required for the transaction of its business and the functions, duties and powers of the subcommittees so constituted shall be as fixed by the Committee.

* Inserted by the First Amendment.

@ Deleted by the First Amendment.

Annex 4.3

Health Services in Nepal

The health sector in Nepal is presently characterized by poor health sector indicators.[57] To address this situation, HMG/N promulgated the National Health Policy, 1991 and the subsequent development of the Second Long Term Health Plan (SLTHP, 1997 – 2017) and the Eighth, Ninth and Tenth Development Plans (Adhikari and Maskay, 2004). A compact of all these strategies with necessary improvements have been translated into "Health Sector Strategy: An agenda for reform", 2003 and "Nepal Health sector Program- implementation Plan" (NHSP-IP), 2004 which aim for the attainment of equitable and high quality health care system for the Nepalese population. Accordingly, HMG/N has identified three programme outputs through a Health Sector Reforms Strategy Programme: (1) Prioritized essential health care services (2) Decentralized management of health facilities and (3) The role of the private sector and NGOs in the delivery of health services recognized and developed with participative representation at all levels which ensure consumers get access to cost effective high quality services that offer value for money.

The government considered Output (1) aimed towards ensuring that the poor and the vulnerable population have priority for access while regarding output as its primary responsibility and make necessary arrangement for costing, allocation and implementation. Regarding output (2), the government has aimed to make local bodies responsible and capable of managing health facilities in a participative, accountable and transparent way with effective support from Ministry of Health, HMG/N and its sector partners. Programmes of community management of sub-health posts, the lowest unit of public health facilities and hospital autonomy and resource mobilization at the district and higher level have been designed for attainment of this objective. Regarding output (3), separate provision have been designed for the NGO and the private sectors with public-NGO partnership contributing mainly in the provision of essential and preventive health care while the role of the private sector has been delineated for provision of highly specialized health care services.

Trade in health services, however, is not a new phenomenon in Nepal. Nepalese people have been seeking health care from the health facilities in the cities of India, Thailand etc. Similarly Indian specialists visiting Nepal provide services to Nepalese

[57] For instance infant and child mortality are 66.78 and 108.78 per thousand live births while crude birth rate and crude death rate are 34.1 and 10.3 percent respectively. The life expectancy at birth is 58.25 years while 50.5 percent of all children suffer from chronic malnourishment (UNDP, 2004). These figures are low standards even among the countries in the region. In addition, significant diversities exist among topographical regions making the market fragmented and delivery of all basic services difficult. This has resulted in great gaps in the health sector performance for instance, the life expectancy at birth ranges from 70 years for Kathmandu, the district where the capital is located to 44 years for Mugu, one of the total 75 districts in Nepal.

patients through private hospitals and nursing homes in Nepal with there being a large number of Nepalese students graduate from medical colleges in foreign countries. Further, there has been flows of health related FDI into Nepal, the first (a Nursing home with Chinese FDI) was granted permission for operation in 1991. In this regard and even after about one and a half decade, the operating FDI of the seven firms total about Rs. 1.6 billion (approximately US$ 231 million).[58] The present situation of health related FDI is provided in Table 6.

Table 6 Foreign Direct Investment in Health Services (Rs. in thousand)

S. No.	Category	No. of firms.	Total				Average			
			Foreign Invest. (Rs.)	Local employ	Foreign employ	Total employ	Foreign Invest. (Rs.)	Local employ	Foreign employ	Total employ
1.	Operating	7	1617636	877	138	1015	231091	125	20	145
2.	Approved	4	1445662	1524	1531	1531	361415	381	2	383
3.	Liquidated	4	32507	330	333	333	8127	83	1	84
	Total	15	3095805	2731	2002	2879	600633	589	23	612

Source: Authors calculation based on raw data obtained from Department of Industry, HMG/N (August, 2005)

[58] About four firms have obtained approval for operation while four firms have liquidated. This somewhat making a total figure of 15 firms under liberalized trade in service in the health sector.

Annex 4.4

Investment Incentive for FDI in Nepal

Based on Procedural Manual for Foreign Investment in Nepal (DOI, 2005) and Other Sources

Fiscal and Financial incentives
Income tax exemption: Corporate tax shall not exceed 20 percent of profits for industries other than manufacturing cigarettes, bidi, cigar, tobacco, alcohol and beer; a 5% income tax will be imposed on dividends earned out of investment in any industry. Export earnings are taxed at 40% of the income tax imposed on other industries; however, the tax amount shall not exceed 0.5% of the total export amount.

Income tax deductions: Income tax rebate of 30, 25 and 20 percent will be granted to industries other than cigarettes, bidi, cigar, tobacco, alcohol and beer, established and operating in remote, undeveloped and underdeveloped regions. Industries are allowed to calculate depreciation on the fixed assets by adding one third to the rate of depreciation allowed under existing income tax laws, depreciation rate ranging between 5-25% as per income tax rule. Industries other than those manufacturing stated tobacco and alcoholic products, utilizing 80 percent or more of the local raw materials for their production and employing all the manpower from among Nepalese citizens are granted a rebate at the rate of 10% of the income tax. If an industry diversifies itself through reinvestment in the same or any other industry, or expands its installed capacity by 25% or more, modernizes its technology or develops ancillary industries, it is entitled to a deduction of 40 percent of the new additional fixed assets from its taxable income. Such remission may be deducted on a lump sum or on an installment basis within a period of three years. If a single industry provides direct employment to 600 or more Nepalese citizens round the year, it will be, in addition to other facilities, granted an additional income tax rebate at the rate of 10% for that year. Industries are also entitled for a reduction of up to 50% from the taxable income for the investment on pollution control process and equipments. Industries are allowed to capitalize the pre-operation cost incurred by the industry for skill development and training. After an industry comes into operation, 10 percent of the gross product is allowed to be deducted against taxable income on account of expenditure related to technology, product development and efficiency improvement. While assessing taxable income, up to 5% of the gross income spent for advertisement of the products, promotional services, hospitality and any other similar expenses are allowed to be deducted.

Concessional Rates of Customs Duties: Manufacturing industries importing plant, machinery and equipment required for direct production process falling under the chapter 84 of the harmonized customs classification with the duty rate of 5 percent are given 50 percent rebate on the customs duty and full exemption from any sales tax. Export oriented industries may obtain the facilities of bonded warehouse. The raw materials can be imported just by entering into a passbook without paying any custom duty or sales tax. Those raw materials are deducted from the passbook upon export of finished products

Excise duty rebate and Refund Industries established and operating in remote, undeveloped and underdeveloped areas are entitled to 35, 25 and 15 percent rebate in the excise duty respectively for a period of ten years from the date of operation. If any industry utilizes locally available raw materials, chemicals and packing materials etc. on which excises or sales tax or both are already imposed, such duty and tax are refunded or adjusted against the payment of such tax and duty to be made by the industry. It is also possible to obtain these raw materials, chemicals and packing materials from the manufacturer directly without paying the excise duty and the sales tax.

Duty draw-backs: Any duty or taxes levied on the raw material, auxiliary raw materials etc. used in producing goods for export are entitled to get refund of these duty and taxes based on the quantity of export. Bonded warehouse facilities:

Repatriation of profits, salaries and allowances: As per the Foreign Investment and Technology Transfer Act, 1992, a foreign investor making in foreign currency is entitled to repatriate- amount received by the sale of the share of foreign investment as a whole or any part thereof; the amount received as profit or dividend from foreign investment; the amount received as payment of principal and interest on any foreign loan; the amount under agreement for technology transfer in such currency as set forth in the concerned agreement as approved by the DOI. Foreign nationals working in any industry with prior approval of the Department of Labour and who comes from a country where convertible foreign currency is in circulation may repatriate his/her salaries allowances, emoluments etc. in convertible foreign currency in an amount not exceeding 75% of such salaries, allowances and emoluments.

Infrastructure Incentives

The government has committed to give priority to arrange infrastructures required for the establishment of industries and to provide government land or industrial districts for establishment of industries**.** A dry port in the Nepal India Border area of Birgunj is in operation. Trains of Indian Railway come to the port from the Indian harbour at Calcutta twice a week. Container services including the bonded warehouse and duty drawbacks scheme is operational. Small exporters with relatively weak financial positions can sell their products to the Export Promotion House (EPH). Nepal borders with the worlds two most populated and growing economies of China and India and is linked to them by roads. This provides a huge scope for the economy of scale through market competition. There are ….. joint venture Banks in Nepal operating in most of the major cities of Nepal. There are altogether 18 insurance companies operating in life and non-life insurance. After the membership in the WTO, the insurance business has been made accessible to foreign insurance companies too (MOF, 2005)

Skill Incentives

Nepal has committed to allow capitalization of pre-operating expenses incurred in connection with skill development and training.

Regarding existing skill situation, the national adult literacy rate (age 15 years and above) for the country is 48 percent, which is quite low in the region. The adult literacy rate for urban areas (75 percent), however, is not very low (CBS, 2004). There are five Universities operational in Nepal. Tribhuvan University being the largest public sector University among them. About 1000 lower, middle and high level manpower in engineering, about 600 manpower in medicine and 5000 manpower in science and technology graduate from Tribhuvan University every year (MOF, 2005). A large number of private colleges affiliated to the private universities provide a wide range of technical education. The Council for Technical Education and Vocational Training (CTEVT) trains lowers level technical manpower through its branches in different parts of the country. A large number of students go abroad for further study in India, China, USA and European countries as shown by the number of students receiving foreign exchange from the central Bank of Nepal. The Industrial Enterprises Act 1992 has made provision of recruiting manpower required for any industry from among Nepalese citizens. However, if any industry cannot be operated with Nepalese citizens, expatriates or foreign nationals can be appointed with prior approval from the Department of Labour from a maximum period of five years with provision for an additional period of five years.

Regulatory processes

Foreign investors can own up to hundred percent in equity share. Foreign investments are open in all areas except a few (consisting of industries related mainly to tobacco, alcoholic and security). The Industrial Enterprise Act 1992 has guaranteed that there will be no nationalization of privately owned industries. Except industries that affect security and public health, no other industries need to obtain any license or permission for establishment and operation. They just need to be registered with the concerned Department. Time bound decision processes: decisions regarding industrial license; registration and duty drawbacks are to be made within 30, 21 and 60 days from date of application respectively. Non tourist visa for carrying out studies for investment and business/ residential visa for foreign investors provisioned to enhance further simplicity. Licenses are not required for the export of products other than banned items or quantitatively restricted items as notified by HMG/N. In case of quantitatively restricted items, export licenses will be in consultation with the private sector. Exports will be charged minimal taxes.

Nepal is a member of the World Intellectual Property Right Organization (WIPO) and Multilateral Investment Guarantee Agency (MIGA); Nepal has entered into bilateral investment treaties (BITs) with counties such as France, Germany, United Kingdom and Mauritus. Nepal has entered into Double Taxation

Trade Treaties (DTTs) with nine countries namely India, China, Pakistan, Srilanka, Thailand, Norway, Mauritius, Austria and Republic of South Korea. To ensure access to a vast potential market, Nepal is a member of WTO, SAFTA and BIM- STEC. Nepal is a signatory to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States and a member of International Centre for the Settlement of Investment Disputes (ICSID), associated with the World Bank. For preferential entry into India, the industrial product must comply with the conditions mentioned in the Treaty of Trade between HMG/N and the Government of India. As per the treaty, all products manufactured in Nepal, with some exceptions related to nature of the product and origin in third countries, are eligible for preferential entry into India. The preferential entry implies that no customs duty shall be applicable to the goods manufactured in Nepal that enter into India. Only the taxes that are applicable to the local products in India are applicable to those industrial products.

Opening of Foreign Exchange Accounts: Foreigners and companies can open and operate foreign exchange accounts in any of the commercial banks of Nepal. Export oriented industrial companies can also open foreign exchange account. Industries incorporated as 100 percent foreign owned or as a joint venture may also open a foreign exchange account to deposit the equity share of the foreign party in convertible currencies.

Annex 4.5

Schedule of Nepal's Specific Commitments in Health Related and Social Services

HEALTH RELATED AND SOCIAL SERVICES
Modes of Supply (1) cross border supply (2) consumption abroad (3) Commercial presence (4) presence of natural persons

Sector or Sub-sectors	Limitations of Market Access	Limitations of National Treatment	Additional Commitments
1. Hospital Services (CPC 9311) and direct ownership and management by contract of such facilities on a "for fee" basis	(1) None (2) None (3) None, except only through incorporation in Nepal and with maximum foreign equity capital of 51 percent. (4) Unbound, except at indicated in the horizontal section. Medical experts can work with the permission of Nepal Medical Council maximum of one year.	1) None (2) None (3) None (4) Unbound, except at indicated in the horizontal section.	

Source: WT/ACC/NPL/