

# Realising potential

- Latest power pacts have renewed optimism
- Nepal-India economic relations

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KATHMANDU, JAN 26 - Last six months saw the signing of the Power Trade Agreement (PTA) between Nepal and India, Project Development Agreement (PDA) between Investment Board of Nepal (IBN) and two Indian companies for Upper Karnali and Arun III Hydropower Projects, and endorsement of a Rs 40 billion investment proposal of Reliance Cement Industries, India.

As the Narendra Modi-led government prioritises the neighbours, these developments have renewed the optimism about Nepal-India economic cooperation.

The PTA is expected to encourage international investors to invest in Nepal's hydropower sector being assured of the vast Indian market, while the two PDAs are expected to boost confidence of investors willing put money in Nepal's water resources.

The agreements were signed in less controversial circumstances this time, unlike the previous Koshi, Gandak and Mahakali treaties.

Experts said the latest agreements have boosted cooperation in the untapped power sector. "The signing of the PTA is a milestone in Nepal-India trade, and it could have a very positive impact on Nepal's economy," said Purusottam Ojha, former commerce secretary.

Nepal had been urging India for the PTA since 2010, but the deal was reached only after the initiatives taken by new Indian leadership.

India has also been generous in providing concessional loans, with Modi announcing \$1-billion line of credit, the single biggest Indian credit to Nepal so far.

In 1996, the Indian government, under the leadership of late IK Gujral, had helped in Nepal's industrialisation and boosting exports to the southern neighbour. In 1999, Nepal and India renewed the trade and transit treaties, which further helped expand Nepal's exports to India and eased trade with third countries.

In the Trade Treaty of 1996, India provided duty free access to Nepali goods that were certified by Nepal authorities as Napal-originated goods. India also allowed goods imported from third countries to arrive in Nepal without further checks once one-time lock is made in containers in Kolkata. The trade treaty was revised in 2001, which imposed quantitative restriction on four Nepali products and the restriction still continues. "Now, India has once again been generous towards Nepal, and the latter has to seek to revise the Trade Treaty, Transit Treaty and Railway Agreement for greater benefit," said Ojha.

## Enhancing Bilateral Trade

Nepal is heavily dependent on India when it comes to foreign trade. India accounts for Nepal's two-third trade, both in terms of export and import.

In the 90s, Nepal's trade dependence with India was less than 20 percent, which surged to around 60 percent in 2000s, and rose to 66 percent last fiscal year.

Although bilateral trade increased to Rs 532 billion, exports amounted to just Rs 59 billion, resulting in a huge trade deficit. "In the past, manufactured goods were more imported, but lately, there has been a massive rise in the imports of agriculture goods," said trade expert Posh Raj Pandey.

According to Trade and Export Promotion Centre (TEPC), Nepal imported farm products worth Rs 127.51 billion in the last fiscal year, up from Rs 99.35 in the previous fiscal. “Due to a massive subsidy India offers to its agriculture sector, Nepali agriculture products cannot compete,” said Pandey. “That’s why we have to consider imposing a certain duty on Indian agricultural goods by taking India into confidence.” Nepal and India have both provided duty-free market access to agriculture products on a reciprocal basis, but the southern neighbour also provides such a facility to Nepali industrial products, which Nepal does not.

However, Nepali manufacturing sector has failed to take benefit of the facility. As Nepal’s manufacturing sector suffered due to poor infrastructure such as power crisis, poor road, and political and policy instability, they lost competitiveness. However, Indian multinational companies like Dabur Nepal are exporting their products such as juice on a large scale.

“The duty-free market access offers a great scope of attracting foreign investment, particularly from India, provided we create a conducive business environment,” said Ojha. “They can target the vast markets of West Begal, Bihar and Uttar Pradesh.”

With the PTA allowing the trade of energy as other commodities, Nepal can also work to reduce the growing trade deficit by exporting power and import substitution of petroleum products. “With hydropower development, we can reduce the import of petroleum products,” said Pandey.

## Promoting investment

India has traditionally been the largest investment partner of Nepal. Most of the big multinational companies like Uniliver Nepal, Dabur Nepal and Surya Nepal are from India.

And lately, there has been massive FDI commitments from India, particularly in energy sector. The signing of the PDA secured huge Indian investments. GMR-ITD Consortium is developing Upper Karnali and Satluj Jal Vidyut Nigam is developing Arun III and they have proposed Rs 140 billion and Rs 82 billion investments, respectively. Two Indian companies—New Delhi-based Oriental Structure Engineers and a consortium of IL & FS Transportation Network, IL & FS Engineering & Construction and Suryavir Infrastructure Construction based in Mumbai—are competing for the Kathmandu -Tarai Fast Track Project, which is estimated to cost more than Rs 100 billion.

According to the Department of Industry, a joint venture of SC Power Company, Nepal and KSK Ventures Limited India has pledged Rs 33.68 billion for the development of a hydropower project in Kalikot. The Indian company holds an 80 percent stake in the joint venture. According to Ananda Chaudhary, manager of Nepal-based Naulo Nepal Hydroelectric Private Limited, a subsidiary of Patel Energy Resource of Mumbai, Indian investors are willing to develop export-oriented hydro projects have two major concerns—the lack of cross-border transmission lines and the absence of an electricity trading company.

He said Naulo Nepal has sought generation license for 130MW Budhigandaki A and 260MW Budhigandaki B projects after completing the survey. He said Indian investors are more concerned about infrastructure rather than political risks.

According to the Department of Industry, the hydropower sector has received the largest investment commitment from Indian companies, followed by manufacturing and services sectors.

In order to increase encourage Indian investment, the two countries signed the Bilateral Investment Protection and Promotion Agreement (Bippa) in 2011 during then Prime Minister Baburam Bhattarai’s India visit, but Nepal’s Parliament has yet to endorsed the agreement. “Bippa is one of the most important agreements, but unfortunately, it has not been endorsed yet,” Ojha said.

## Comprehensive partnership

Nepal and India have signed several agreements related to economy and trade, but experts say a comprehensive partnership agreement could help boosting trade and investment between the countries. “There is a need for deeper integration for Nepal to benefit from a booming Indian economy,” said Pandey. “Such an integration will happen when the two countries go for a comprehensive partnership agreement.”

He said a comprehensive partnership agreement involving trade of energy, goods and services, bilateral investment promotion, and exchange rate, among others, would give Nepal an edge to bargain with India on Nepal's crucial economic interests, while addressing India's economic interest in Nepal. "Under different agreements currently, India is the giver and Nepal is the taker," said Pandey. "Under a comprehensive partnership, Nepal will also be in the position to give, which enhances Nepal's bargaining power."

## **Indian MNCs betting big on Nepal**

The opening of the economy in the 90s was a turning point for Indian multinationals to come and invest in Nepal.

The beginning of the partnership still continues, with the likes of Reliance, GMR, Sutluj making fresh investment in Nepal.

If it was the manufacturing sector that saw huge investments from Indian MNCs then, the power sector is where Indian companies are investing now.

Thanks to the economic liberalisation, the 1990s saw leading Indian companies like Dabur, Asian Paints, Berger Paints, Colgate Palmolive, SBI Bank, Punjab National Bank and Unilever enter Nepal to set up joint ventures (JVs) or wholly-owned subsidiaries.

One of the factors fuelling the interest of Indian companies in the 1990s in Nepal was its more liberal trade policy. The import tariff was drastically reduced, and also a number of tariff slabs. In addition, establishment of bonded warehouses and introduction of a duty drawback scheme reduced the previous trade policy's anti-export bias.

Complementing this overall trade reform programme was the landmark Nepal-India Trade Treaty in 1996 that allowed India to import goods from Nepal free of import duty and quantitative restrictions if the goods were manufactured in Nepal (except those on the negative list). This treaty was another high point for the country to woo MNCs, including those from India.

The success of the 1990s prompted Surya Nepal, Unilever and Dabur to scale up capacity and venture into new businesses. After cigarette, Surya Nepal went for readymade garment production and export, while Dabur started juice and health care businesses. Though Surya Nepal closed down its garment unit, the company is now looking to enter new sectors, including hospitality. Recently, it established one more cigarette production unit in Tanahu.

One of the characteristics of multinationals in the last two decades has been they have been the leaders in the sectors they have entered. Unilever led the fast moving consumer goods (FMCG) segment, Surya Nepal is the undisputed leader in the cigarette business.

For some of the Indian MNCs, their JVs in Nepal are their important businesses. Dabur Nepal accounts for 10 percent of Dabur's entire business, but the most important aspect is Dabur Nepal's juice plant in Birgunj is the main supply centre for Dabur's juice business. In fact, it can be called the "mother factory" for Dabur's juice business. About 70-75 percent of Dabur's juice production comes from this factory. "We have been continuously investing in Nepal," said Abhay Gorkhali, marketing head of Dabur Nepal. "As we export juice to India, we are also playing role to reduce, to some extent, the trade deficit that Nepal has with India."

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