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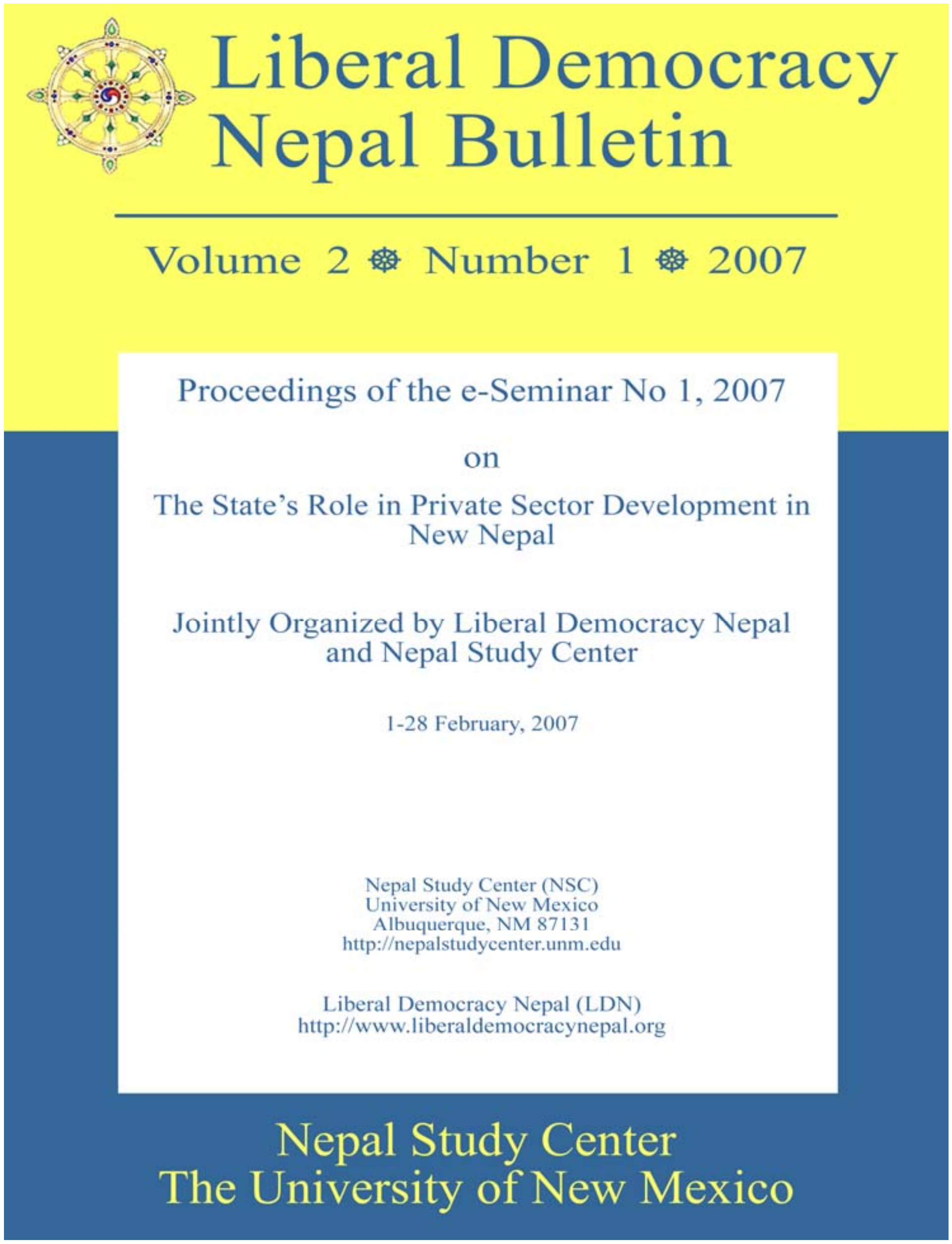
Proceedings of the Joint Liberal Democracy Nepal and Nepal Study Center e-Seminar on The States Role in Private Sector Development in New Nepal'

Liberal Democracy Nepal



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on

The State's Role in Private Sector Development in New Nepal

Jointly Organized by Liberal Democracy Nepal and Nepal Study Center

1-28 February, 2007

Nepal Study Center (NSC)
University of New Mexico
Albuquerque, NM 87131
http://nepalstudycenter.unm.edu

Liberal Democracy Nepal (LDN)
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Guest Editors and Moderators
Mallika Shakya
Vijaya R. Sharma

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Detailed proceedings of this e-seminar are available at:
http://nepalstudycenter.unm.edu/Eseminars_workshops.htm

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Liberal Democracy Nepal Bulletin (LDNB) focuses on the contemporary political economy, democratic development, good governance, international relations, and conflict resolution in Nepal and invites high quality essays and commentaries for publication.

Electronic submissions are accepted for journals. For detailed guidelines on submission and related matters, please visit http://nepalstudycenter.unm.edu/journals/LDNB/ldnb.htm Send your inquiries to Professor Alok K. Bohara, Nepal Study Center, Department of Economics, University of New Mexico, Albuquerque, NM 87131, U.S.A. (505) 277-5903, Bohara@unm.edu.

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Foreword

Liberal Democracy Nepal Bulletin (LDNB) is pleased to publish the proceedings of its first e-seminar "State's Role in Private Sector Development". This e-seminar was collaboration between the Nepal Study Center (NSC) of the University of New Mexico and its affiliate Liberal Democracy Nepal (LDN).

This innovative e-seminar utilized modern technology to bring people from various locations and continents together and to enable them to simultaneously participate in the seminar deliberations. We are pleased that so many accomplished and renowned academics, professionals and policy makers actively contributed to the seminar from Nepal and the USA.

The NSC conducts research, undertakes collaborative projects to promote education, organizes annual policy related conferences, and provides regular speaking platform for prominent scholars from Nepal and others who are interested in development in Nepal.

Since its inception in 2005, LDN has been active in promoting academic and professional deliberations related to the issues of development in Nepal. LDN's efforts have included workshop with Nepali leaders and US organizations, publications of papers, organization of discussions on timely topics in Nepal, and publishing major papers, commentaries and articles by prominent Nepali academicians on current issues. LDN has also collaborated with NSC to organize conferences, talk programs and discussion forums related to political economy in Nepal.

We are grateful to Ms. Mallika Shakya and Dr. Vijaya Sharma for moderating this notable e-seminar. The thoughtful paper by Ms. Mallika Shakya "The State's Role in Private Sector Development in Nepal" became the basis for the lively and meaningful discussions that followed.

We also wish to thank all the seminar participants, discussants and contributors who helped to make this seminar a success. LDN also wishes to thank its policy group for their support and guidance.

We are grateful to Mr. Bishal KC and Mr. Prakash Adhikari for the technical support they provided in organizing this seminar. LDN invites

your support in continuing these academic deliberations to help and advise policy makers, politicians and academicians in Nepal. This e-portal can be successfully utilized to organize other e-seminars relevant to the rapidly unfolding events in Nepal.

LDNB will welcome your comments on this publication.

Sincerely

Prof. Alok K. Bohara, University of New Mexico
Dr. Ambika P. Adhikari, Arizona State University
For Editorial Board, Liberal Democracy Nepal Bulletin (LDNB)

Foreword

Since its inception two years ago, the Nepal Study Center at the University of New Mexico has developed and grown remarkably. Through inspired leadership and by building a network of scholars and thinkers, the Center has gone uniquely global by tapping into the power of the Internet.

Within this short period of time the Center has published e-journals and newsletters, has held a highly successful conference at the University of Wisconsin, and developed an electronic document repository. It has also been successful in attracting quality students from Nepal to the graduate program in Economics. The NSC is quickly becoming a focal point for students and researchers in the University and wider academic community.

One of the remarkable features of the NSC is its use of state-of-the-art technologies to gather, archive and disseminate information. This e-seminar, a first of its kind for the Center, pushes the envelope even further, bringing ideas and arguments from those all over the world, to those all over the world.

Through this e-seminar the Nepal Study Center clearly shows its potential to become a portal for people and ideas to meet, exchange and develop. Although particularly focussed on issues in the Himalayan region, the technologies, the methods and the fundamental theoretical ideas have global significance.

All those involved in this e-seminar should be congratulated and encouraged to continue this innovative and important work.

Sincerely
Prof. Philip T Ganderton
Professor and Chair,
Economics Department
University of New Mexico

GLOSSARY

CA	Constituent assembly
CNI	Confederation for Nepalese Industries
EPA	Export promotion agency
EPZ	Export processing zone
FDI	Foreign direct investment
FNCCI	Federation for Nepalese Chamber of Commerce & Industries
FTZ	Free trade zone
GDP	Gross domestic product
HJDD	Himalayan Journal of Development and Democracy
HPRC	Himalayan Policy Research Conference
IPP	Independent power purchasers
LDC	Least developed countries
LDN	Liberal Democracy Nepal (a diaspora forum)
LDNB	Liberal Democracy Nepal Bulletin
MFI	Micro-finance institution
MOF	Ministry of Finance
MOICS	Ministry of Industries, Commerce & Supplies
MSME	Micro, small and medium enterprises
NEA	Nepal Electricity Authority
NPC	National Planning Commission, Nepal
NRN	Non-resident Nepalis
NSC	Nepal Study Center, The University of New Mexico
PE	Public enterprises
PSD	Private sector development
RECAST	Research Center for Applied Science and Technology
RONAST	Royal Nepal Academy of Science and Technology
SEZ	Special economic zone
SPA	The Seven-Party Alliance, Nepal
SME	Small and medium enterprises
UNM	University of New Mexico
VDC	Village development committee
WTO	World Trade Organization

Liberal Democracy Nepal Bulletin, Vol. 2, No. 1, 2007

The State's role in Private Sector Development (PSD) in New Nepal

Mallika Shakya[1]

Anthropologists, political scientists and historians have often criticized the tendency of economists to pay inadequate attention to politics and culture in investigating the operation of societies in general and the process of economic development in particular. While these are often ignored as unavoidable interdisciplinary criticisms under normal circumstances; the politico-economic nexus demands an honest problematisation especially in times of transition. A discourse on economic development during political transitions will have little meaning if done in isolation from the discourses on economic globalization on the one hand and localization of politics and culture on the other.

Nepal is currently in a deep political, cultural and economic transition. The popular political uprising Nepal witnessed in April 2006, calling for an end of the royal autocracy and reinstatement of political pluralism, is the third major popular uprising the country has witnessed in just over half a century. The uprising demonstrates Nepal and Nepali's deep aspirations and commitment for liberalism and pluralism. A closer look at the uprising also shows that it is firmly underpinned by a series of developments and events accumulated over the course of two preceding decades when Nepal practiced economic and political liberalism.

The political transformations brought in by the April uprising into Nepal's political landscape are only the beginnings of a long and winding road to State-restructuring. At some point, these will have to cross paths with social and developmental elements in order to be able to deliver on the popular demands of sustainable peace, social reconstruction, and a rise in the living standards, which are the three pillars on which State-building stands. The entwining of transitional politics and economic development forms the core of this paper. The paper starts with the postulation that the

[1] Mallika Shakya is a PhD student at London School of Economics (LSE) currently working for the World Bank. The views expressed in this paper are those of the author in her personal capacity, and not necessarily those of the World Bank.

The paper was presented at the LDN/NSC joint e-seminar, February 1-28, 2007. The author is grateful to the substantial comments provided by the designated discussants. The paper also benefited from the rigorous virtual floor discussion during February 16-28, 2007. The errors remaining are the author's alone.

economic and political institutions have a symbiotic relationship in Nepal as elsewhere. On the one hand, the newly emerging political building blocks, including those that preach federalism and local autonomy, will continue to exert influence on the economic equations currently in place. On the other hand, the political visions will come true and will be sustained only if they have firm economic underpinnings. This is my point of departure.

Firstly, the paper and the subsequent e-discussion suggest that the new political dimensions currently evolving in Nepal cannot be studied in geographic isolation. The rapidly changing global and regional economic equations will continue to exert profound influences not only on the economic aspirations of Nepal and the Nepalis but also on the maneuvering space available for its economic policy-making. Secondly, the paper demonstrates that ‘industry’ is not a single concept but an eclectic one, and the politics-industry nexus in Nepal will continue to take varied forms across industrial sectors.

I use the term ‘industrial development’ synonymously with ‘private sector development (PSD),’ and argue that it is central to securing and sustaining economic growth in post-conflict Nepal. The aim of this paper is NOT to offer solutions for private sector development in Nepal, but to identify pertinent issues that must be addressed for a PSD strategy to be conceptually coherent and pragmatically doable especially at the time of transition. This paper signposts a number of specific policy measures and programmatic interventions that have been adopted in other countries under similar circumstances so as to provide food for thought in initiating a dialogue in this direction. Subsequently, the paper has benefited from the e-seminar discussion that took place during February 1-28, 2007, which had the participation of 55 members from Nepal and the Nepali diasporas abroad who bring with them deep insights and long experiences in this field.

A discussion on PSD can be approached in a number of ways. This paper will take a three-dimensional approach. The first section will introduce and contextualize the Nepalese private sector in the rapidly transforming global economics and local politics. The second section will engage in a more in-depth discussion on the nature and construction of the two pillars of the Nepalese private sector (i.e., the labor-intensive industries including the MSMEs and the capital-intensive large sectors) vis-à-vis public policy measures essential for their well-being. Section 3 will discuss the missing links between PSD and human/social development. The last section will summarize the discussion.

1. Nepal's private sector development at the crossroads

Nationally, Nepal is at the outset of a historic change. Since May 2006, we are witnessing a linear evolution – though with inevitable periodic punctuations – where the building blocks for New Nepal are slowly beginning to take shape: The first session of the parliament reinstated after the April uprising called for an ambitious social/gender inclusion program in favor of the marginalized ethnic, regional and gender groups. Outside the parliament, the Maoists have called for a draconian redistribution of economic resources (e.g. land ownership) and entrepreneurial opportunities (e.g. renewed emphasis on tailor-made FDI for infrastructure industry and a new vision for the development of micro, small and medium enterprises) in favor of the marginalized groups. As the Seven Party Alliance (SPA) and the Maoists proceed towards election of the constituent assembly amidst intensifying demands for restructuring of the governance structure – including possibilities of federalism and regional autonomy – speculations are high that the currently formed interim parliament and the soon to be elected constituent assembly might both evolve as the vehicles for intensifying actions towards internalization of the gender, ethnic and regional issues within the economic and political policy-making.

Affirmative action and redistribution of resources are not disasters for capitalism and a market-based economy as is often feared. Contrary, they can emerge to be unique opportunities for much needed entrepreneurial change. For example, the post-apartheid government led by the African National Congress (ANC) in South Africa implemented a draconian Black Economic Empowerment (BEE) program, which successfully accomplished an ambitious housing and land redistribution program towards inclusion of its black population. The State also mandated that all economic enterprises must ensure significant shares of economic interests to the black people (BEE Act, 2003). In contrast, the land reform program in Zimbabwe has invoked wide international criticisms and reports of misallocation of resources and provocations that are destructive to local harmony.

After the spates of rebellion and reconciliation, both of which signal clear gender/ethnic nuances, it is not too early for Nepal's policymakers working on PSD to proactively strategize on these fronts. We have already witnessed how the Maoists' 'great leap of nationalism,' called for during the second Maoist general convention held in February 2001, translated into ultra-leftist labor movement, which for the first time differentiated the labor unions' treatment of factory owners as per their ethnicities (Shakya, forthcoming). The Maoist propositions of resources redistribution and affirmative action are bound to exert direct or indirect impacts on PSD in the coming months and years. It is important that a discussion on PSD in New Nepal explores a 'middle ground' where popular concerns about ethnic and gender inclusion are well addressed without making self-destructive compromises on the market rigor.

<u>At an international level</u>, China and India are not only emerging as the roaring and shining giants who have begun to flex their muscles in the global economy; increasingly the interrelationship between the two is taking form of a strategic alliance than cut-throat rivalry as has been the case before. This has a number of implications for Nepal: First, there is a widening avenue for Nepal to seek the role of a *jholunge* [bridge] between the two growing economic powers as opposed to its conventional strategy where it has maintained itself to be the *dui dhungako tarul* [a buffer zone] between the two warring giants. Second, as the Chinese and Indian knowledge-economies increasingly catch up with their financial booms, it makes all the more plausible that Nepal's quest for FDI and technology transfer can be quenched within the region than by turning to far-away Western multinationals. We are already beginning to learn that successful bidders for Nepal's infrastructure construction projects no longer come from Europe and the North America but from within the region and from the regional diasporas abroad. Third, as the Indian and Chinese economic booms give rise to a large middle class with high disposable incomes, Nepal now potentially has access to a vast international market within the continental thresholds. Nepal can not only aspire to become the supplier of the basic commodities for the newly emerging regional middle class, but should also aspire to be the supplier of energy as well as the luxury goods, the demands for which are skyrocketing.

Hydropower is a good example of the growing regional demands for energy. India needs electricity to fuel its economic growth. It is estimated that India needs to add another 100,000 MW by 2012 and 778,000 MW by 2032 (Dhakal, 2007). Coal reserves are of poor quality and oil and gas reserves are small. Hydroelectricity is clean and has a special environmental appeal. The recent economic policies in India have demonstrated preference for hydroelectricity and have sought to develop a new economic model, which ends the State's monopoly in acquisition and distribution of energy. This is bound to have direct implications for Nepal.

Nepal is currently standing at the crossroads where it is faced with a series of opportunities and challenges. Internally, Nepal is caught in a dilemma between economic liberalism and socialist populism. Internationally, it has the possibility of choosing between a doomsday of being the dumping site for its giant neighbors or evolving as a primary beneficiary of the regional knowledge and capital market boom.

2. Differentiating the industrial sectors

The discourse on private sector development is an evolving one. Prior to the 1980s, the nation states all over the third world pursued protectionism and closely guarded State monopoly at least in the key industrial sectors. The 1980s and 1990s were the decades of economic liberalization where economies removed all entry/exit barriers, deregulated their markets, and liberalized their current and capital accounts. At the turn of the millennium, the new school of thought now makes case for the role of 'new' industrial policy that takes a three-tier approach (Rodrik, 2004). It argues that, first, the States should ensure an incentive framework that is economically rigorous and well-disciplined (e.g., fiscal, exchange rate and trade policies, and the business enabling environment). Second, The State should then offer appropriate backbone services of physical and technical infrastructure for the industrial ventures to prosper (e.g., roads, utilities, business development services and finance). And third, the State should form partnership with the private sector to build a firm network of pro-active institutions, which enhance innovation, coordination, and productivity among industries so they become and remain competitive in the global market.

The new industrial policy also makes the case for a differentiated approach among industries. The economic, political, and social realities in the ground also mean that one set of industrial policy will not be suitable for all. For the sake of simplicity, I define my industrial classification as a dichotomous 'big' and 'small' pillar of the private sector.

2.1 The 'big' pillar: Building the platform

The 'big' pillar of Nepal's private sector includes components that involve capital- and technology-intensive sectors such as infrastructure, energy, financial institutions and universities. It is often the case that Nepalis play more the role of consumers of the products and services of these industries than that of the producers, for the simple reason that Nepal lacks the capital, technology and operational knowledge that these sectors demand. In such cases, the onus on Nepal's PSD policymakers is to usher in foreign capital, either in the form of foreign aid or foreign direct investment (FDI), but in such a way that they are cost-effective, market-friendly, and that they do not preempt possibilities of local investment. It often works better if the investment model is unbundled to clearly differentiate the public goods from private goods. The former can be differentiated from the latter on the grounds of gestation period, social commitments, and the exogenous risks involved.

The biggest FDI challenge, however, is that of technology and knowledge transfer. Foreign investment must usher in technology and knowledge transfer, which is not always guaranteed unless the policymakers especially factor this into account from the very outset of the project conception. If we are to learn from the blood diamonds from Africa on one hand and the techno-savvy China on the other hand, the lessons become clear that FDI is a good servant and a bad master. Policymakers must restrain from the temptations to patch every problem with a cheap slogan of nationalism. In the meantime, they must prevent FDI from turning into an uncontrollable monster.

2.2 The myth of the hydro-electricity panacea

The pioneers of FDI in hydro-electricity generation have vitiated the local market such that FDI in power sector has now become an anathema within Nepal. Internationally, the political instability has given such bad name to investment in Nepal that funds are no longer easy to mobilize. Foreign grants are desirable but often come with unjustifiable conditionalities that excruciate project costs. For example, the mid-Marsyangdi project was funded through German foreign aid, which came with the conditionality that the FIDIC engineers for the project who estimate all project variation costs be selected through limited competition among the German nationals. As a result, a series of variations throughout the project saw the project cost rise up to USD 5450 per KW, which is one of the highest among all hydro electricity projects. In contrast, Chilime designated local expertise for FIDIC duties and secured a production cost as low as 1583 per KW (See Bhattarai, 2007 in e-seminar floor discussion).

Investors from the region or the regional-diasporas abroad are increasingly proposing the recent private hydropower development projects. They are better suited to operate in Nepal not only due to their physical and cultural proximity, but their ability to obtain in-depth information on Nepal's political and capital market volatilities. Such detailed information are often not available to investors from far, and hence their 'perceived risk' for investment in Nepal are likely to be estimated higher than the real risk. In addition, bureaucratic clumsiness, lack of transparency, and inconsistency in regulatory procedures might further deter far away investors. Such problems of information asymmetry can be solved through development of internationally accredited credit-rating and risk-rating institutions, combined with regulatory reforms to make administrative procedures consistent and transparent for all.

While a superior investment climate is a must if the State is to usher in healthy competition among the investors and seek out the best investment package, it should also bear in mind that task of hydropower generation is closely connected with the task of distribution. It is increasingly argued that regional investors might be better connected not with regional hydropower generation networks but also the regional distribution networks. One hopes that the Indian economy's double-digit growth and its rising energy consumption need have not gone unnoticed among the policy makers in Nepal. It is estimated that India needs to add another 100,000 MW by 2012 and 778,000 MW by 2032. Coal reserves are of poor quality while oil and gas reserves are not very sizeable. The growing global awareness on environment also adds to the attraction of renewable hydroelectricity.

Nepal should take special note of the fact that the 2003 amendment of the Indian Electricity Act offers scope for private participation in energy trade (Dhakal, 2007). India has increased its involvement in Bhutan's hydro sector, and is looking to import gas and electricity from Bangladesh and Myanmar. It is about time that Nepal lets go its eternal skepticism of engaging with India on hydro-electricity and explore alternative modalities to make use of the new avenues India has opened up for its energy market. The fact that Nepal is working towards developing a new political equation within the country might offer a good platform through which

Nepal can reposition its dealings with India and China more strategically. Once the federal structure takes roots in Nepal, it might even consider the model Bangladesh is currently following for its engagement with the Indian Northeast. Bangladesh is increasingly distancing itself from the central State of India while initiating ground-level negotiations with the regional Indian States to develop distribution networks for its energy as well as consumer goods. The private sector leaders from both sides of the border as well as the role of international mediators have been critical in furthering such relationships (Shakya, 2006b). Nepal could learn from this new possibility. An economically sound alliance between the private hydro investors and distributors between Nepal and India might emerge to be a win-win for both the countries.

While much has been said about the financial and political issues of hydroelectricity generation; a debate on the issues of technicalities and modalities of the project is only beginning to evolve. We should begin with the understanding that hydropower is not an indivisible unit but one that is eclectic. The success of the infrastructure projects in East Asia and elsewhere shows us that competition can be boosted, among others, by unbundling the project into smaller components so the unequal risks of power generation, connectivity and distribution are separately accounted for. There is an ongoing debate as to whether or not Nepal can or should offer merchant power station provisions without a legally binding power purchase agreement. Such a provision will be feasible once Nepal can attract multiple investors and generate ample competition in the market.

Investors might be hesitating to come forth also due to the nascent stage of the financial sector in Nepal, and it will take some time for banks to lend on pure project financing terms where lending is secured purely by the underlying cash flow of projects and contracts. Some common credit enhancement instruments such as direct or indirect guarantees, surety obligations or insurance can be considered by the commercial banks for hydro investment.

The e-seminar floor discussion went on to emphasise that there is a crucial role for an effective public-private-partnership in fostering regulatory and knowledge management as well as financial facilitation for the hydroelectricity development in Nepal. The Nepal Electricity Authority (NEA) appeared to be too bureaucratic and technically challenged a body to deliver on much of these tasks.

2.3 The 'small' pillar on which million Nepalis stand

The 'small' pillar of Nepal's private sector is often a more important one since it concerns the livelihoods of a larger number of people. The role of globalization is important even in this strictly 'local' pillar of the private sector because the MSMEs are increasingly serving their global clients because domestic markets are simply not large enough for a country like Nepal, especially in the niche areas; and that technology and liberalization has made global integration very much a 'local' reality like never before. The new industrial policy rightly claims that the 'new' market is increasingly the one beyond the national borders. Nepal can either run the risk of being inundated by cheap foreign goods from the northern or southern neighbors who have stronger comparative advantage in both scale economics (Smith, 1776) and geography economics (Krugman and Venables, 1995), or it can proactively distinguish its products and seek competitiveness in selected global niche markets.

In fact, most if not all of the Nepal's major export come from sectors that are ethnically or geographically driven, and which pursue niche markets. Tourism, carpet, and the handicrafts, which occupy over 80 per cent of its total export, are only few of the examples. Even in the readymade garments market, which evolved in Nepal largely as a response to the US-granted quota protection, Nepal could compete with Bangladesh and India only in the sub-sector 'niche' of ethnic-contemporary garments (See Shakya, 2004). Such features infer the significance of brand economics for a small economy like Nepal.

Although the State has made some haphazard efforts in this direction, the private sector need for branding is met occasionally by selected business associations and largely by the firms themselves. Contrary, one sees rampant misuse of the national brand by the State. Especially in dealing with cultural capital, the State has not been sufficiently sensitive. A frequently evoked scenario is that of a Brahman-Chhetri State bureaucrat trying to promote tourism highlighting the ancient Sherpa heritage and the pristine Himalayan peaks. Little effort is made to correct for the bureaucrats' lack of interest in the nuances of clientele's needs and a Brahmans' unfamiliarity with the Sherpa culture. Another scenario is that of a non-Newar entrepreneur's endless efforts to gain access to the lucrative metal handicraft industry and his failure to break the Newar clique that currently dominates the market. These are two extreme cases and the reality is a double-edged sword: On the one hand, traditional entrepreneurs are deprived of the legitimate opportunities to take part in modern policy-making and institutional market promotion. On the other hand, modern entrepreneurs do not have access to the traditional skills that are essential for capturing the modern niche markets. Macro policies are often not sufficient to address these archetypal problems that overpower most of the emerging economies. It is important that the State develops creative ways to not only enhance such ethnicity-based cultural capital but also make them accessible to the broader population beyond the ethnic clique. In many cases, this can be done by giving due recognition to the ethnicity-based knowledge systems. The newly emerging ethnicity-politics might have important implications for this aspect of PSD in Nepal.

I emphasize the six key elements of the 'new' industrial policy that is increasingly dominating the post-Washington-Consensus debate on industrial growth. It argues for two important preconditions to industrial policy-making: (i) an incentive framework with economically sound fiscal, exchange rates and trade policies; (ii) infrastructure and backbone services. It then argues for a succession of institutional interventions, including:

1. Access to finance and financial instruments
2. Institutions for brand economics (innovation, standards & quality)
3. Collaboration economics (consortia, industrial clusters, free zones)
4. Market promotion agencies
5. Global supply chain and linkages
6. Business enabling environment (regulatory & competition policies)

The new industrial policy spells out the writing on the wall: Competitiveness based on quality and innovation. With this conviction, this paper appeals for a case for a timely union between 'new' industrial policy and economic liberalism. Nepal has worked relentlessly in the early and mid-1990s towards a sound macro policy. Growth has been meager to say the least. It is perhaps now time for the second leg, i.e., getting its industrial policy right.

A recent World Bank study (2007) on access to finance in Nepal shows that the household access to banks and credit agencies compare well with the neighboring countries, the problem area is that of finance for micro, small and medium enterprises (MSMEs). Entrepreneurs who want faster and easier credit opt for informal finance even at much higher interest rates. Then comes the issue of availability of tailor-made financial instruments which help foster innovation (venture capital, matching grants), increase the speed of monetary churning and better facilitate business transactions (factoring and captive finance), and spread out transaction risks to level the playing field (shipment finance and trade insurance).

That Nepal has better competitive advantage in niche products than scale products needs no convoluted arguing. On the one hand is the argument for a 'Gulliver effect,' referring to the relationship between a small country and large neighbors where the former is better off producing higher value added niche products while leaving scale-based activities to the latter (Blejer and Szapary, 1991). On the other hand is the argument for commercial capitalization of its rich and diverse ethnic and geographic legacies to produce 'distinction' goods and services (Bourdieu, 1984). Several booms and busts in our export portfolio have largely involved niche products such as carpets, handicraft, and pashmina. The booms and busts within an industrial sub-sector – of the readymade garments – has inferred Nepal's failure in scale economics on one hand (Shakya, 2004) and emerging success in niche ethno-contemporary manufacturing on the other hand.

Little efforts are made in Nepal to identify which areas have been more effective in integrating domestic production with global markets. The literature deems contributions of export promoting agencies and local collaboration institutions particularly important in higher innovation sectors. Globally, every dollar invested in a sound export promotion agency (EPA) is estimated to generate over 300 dollar worth of export. But this is going to occur only if they effectively engage in core binding constraints holding export back. In case of Nepal, development and marketing of culture- and geography-based brands for the global markets could be an area the EPAs can effectively work on.

The literature on collaboration economics suggests that industrial clusters push incumbents to upgrade to higher level of quality, innovation, and technology faster by offering solutions to the coordination failures

(Humphrey and Schmitz, 2000). Clusters are an eco-system of firms, benefiting from synergies created by a dense network of competitors, buyers, and suppliers. They also include prodders of complementary products, specialized infrastructure providers, institutions providing specialized training, education, information, research and technical support (such as universities, think-tanks, and vocational training providers) and standards-setting agencies. Successful clusters attract investment by countering coordination failures, as has been seen in the cases of leather and garment clusters in various parts of India, salmon cluster in Chile, technology clusters in Taiwan and Korea, etc. Another structure often developed to counter coordination failures is the export processing zones (EPZs), which are often built as experimentations for specialized infrastructures and regulatory policies and institutions for market products with greater potentials.

Lastly, the generic well-being of the private sector will depend largely on the overall climate for doing business. Nepal ranks 100 out of 175 countries in the Ease of Doing Business index (World Bank, 2006). Within this, a best practice it follows is that it has not set a minimum capital requirement to start a business. Through the deregulation measures of the early 1990s and especially the New Industrial Policy 1992, Nepal has significantly dismantled the Panchayati License Raj and has improved its procedures for starting a business and enforcing contracts. The bottleneck lies, however, in the rigid labor regulations that prevent the industrialists from approaching a flexi-policy to suit the seasonality of his business. It ranks 150 out of 175 countries in an index measuring labor flexibility.

Brand Economics: Cultural Capital

For a country that is opulently blessed with the brand image of summit Shangri-La and wretchedly deprived of the ores of mass manufacturing, branding products is much smarter a move than simply scaling up. In a world where tangible assets and production capacity are in surplus, brands not only create differentiation and thereby drive consumer demand, they also create legal and psychological hedges against competition. Through careful management and skillful promotion, brands come to exert a powerful influence over consumer behavior.

Nepal has plenty of pieces scattered around to build the brand mosaic: the mysticism of the Himalayas, the reminiscence of the hippy serenity, the cradle of Buddhist philosophy and Tibetan arts, the mountain hospitality, the Gurkha gallantry, and now increasingly the myth of ‘cultural’ communists and the reality of women forest protectors. PR experts might be able to brand individual products, but there is a clear role for the State to build a national platform on which individual products can stage their shows. This requires institution-building – both formal and informal. Research institutions should explore the market feasibility; educational institutions should upgrade the quality and technology; certification institutions should build international credibility of claims on standards; legal institutions should develop patent mechanisms; promotion agencies should build bridges between the local makers and global takers. And collectively, the country should develop a holistic and long-term strategy on which individual firms can pin their own brand campaigns.

There are several good examples from India. Its decade-long investment in classical art academies has given formal accreditation to traditional heritage and its masters. This, in turn, has made it possible to codify the art so systematically that these are no longer confined to a tightly knit social circle but accessible to anyone who is prepared to devote considerable time and effort. The advantages are two-fold: First, this adds to the rigor of contestation, and second, it adds to the quality assurance while continually raising bars of excellence. Modern India’s ability to create and nurture a national brand significantly owes to the excellence maintained over centuries and nurtured by its diverse cultural groups.

3. Private Sector role in Public Services: Can there be a happy marriage?

Over 80 per cent of the Nepali population derives their livelihoods from agriculture while contributing to about 40 per cent of the GDP. The agricultural dominance leaves little space for industrial sophistication and diversification on one hand, and denies a supply chain and linkages that are necessary for profitably processing and marketing agricultural products for a rise in productivity on the other hand. Asia as a whole earns only 6 per cent of its GDP from agriculture because it has migrated well to better yielding sphere of industries. As we renew the discussion on the need of a sustainable post-conflict construction, time is ripe to reinitiate the discussion on how could we bridge the gap between agriculture and industries to ensure a sustainable growth rate. What role do micro-credit and co-operatives have in establishing a link between the rural and urban population?

Studies show that the lack of formal capital and infrastructure in the rural areas can be partially compensated by creatively utilizing their rich social capital. The success of collateral-free lending to rural women in Bangladesh and the success Nepal's community forestry model has shown that co-operatives and micro-credit are instruments that have excellent potentials. Having said this, one does have to remember, however, that Nepal does carry a long list of donor- and indigenously-led cooperative programs that have miserably failed not only to sustain but even to take off.

There are a number of ongoing grassroots-level income-generation programs in Nepal. NIRDHAN is carrying out micro-credit in several districts. The Poverty Alleviation Fund (PAF) has recently scaled up its outreach. The success of 'Let us Build Our Own Village' project, which paved way for several of other grassroots level projects, indicate that community mobilization might be the missing formula for Nepal's mass transformation. Such programs might in fact be very timely vehicles through which peace dividend is delivered to the average Nepali in the shortest possible time span.

There are several other avenues through which peace dividend can be delivered through constructive mobilization of the private sector to deliver public goods. The private sector can be mobilized on a competitive basis to deliver basic social services so as to rid the currently incompetent and cost-inefficient State delivery of services. Another modality can even be that of 'education vouchers' whereby the State imposes a modest tax on private schools to mobilize funds for the graduates of the public schools for their higher level education.

The current political transition might actually be a good opportunity for Nepal to come out of its preoccupations and consider a thorough evaluation of its past cooperative schemes as well as private provisioning of public services. Such action might renew the rigorous debate among the local, national and international stakeholders before conceptualizing a new strategy in this area.

4. Concluding remarks

The April 2006 people's movement is the first step in a long process of State-building. This has several implications for the private sector development. On one hand, this can be taken as an opportunity to pledge departure from a bureaucracy-laden 'business-as-usual' to adaptation of a 'new' and rigorous strategy which would construct the basis on which the State can effectively lay out its nuts and bolts of equity- and inclusion-economics without compromising on what might bring the average Nepali the best chance for a rise in living standards. On the other hand, there remains a threat that the achievements of the two decades of economic liberalism gets washed away by radical whims of State interference on the private sector activities, be it in forms of small-scale extortions and harassments or in forms of wholesale redistribution of economic resources and entrepreneurial opportunities that are not economically sound. In either case, in a largely capitalistic global economic order that currently envelops Nepal, the private sector development remains at the core of any discussion on equity, inclusion, and growth.

The April revolution can also be a unique opportunity for the Nepalis to break the vicious cycle of fatalism and cynicism that has long dominated Nepali political and economic history. Capturing this opportunity will require a vision for greasing the nuts and bolts of PSD on various fronts of: Finance, promotion and incentives, standards and innovation, commercial capitalization of the cultural capital, logistics and regulatory environment. Capturing this opportunity will also require a vision for creative use of the country's social, cultural, and geographic capital in addition to the economic capital. This essentially means bringing depth and precision in the application of the industrial policy: In addition to broad macro policies, PSD also needs sound and effective meso policies and institutional establishments in order to achieve the goals in especially challenging circumstances. The time is ripe for the PSD policymakers to develop a strategic grand vision to tackle the nexus between the new and the old wisdom on the making of industrial policies.

This paper has attempted to offer some food for thought for a discussion on Nepal's PSD agenda. The paper commenced by conceptualizing the contours of Nepal's private sector against a South-Asia-wide politico-economic context. It then identified a number of structural and sectoral components that are essential for the development of Nepal's eclectic private sector. In addition to the issue of access to finance and financial instruments, these components include the issues of promotion and incentives for innovation and branding, technology transfer, and regulatory environment. Finally, the paper briefly outlined the scope for the private sector in delivery of public services and in enhancing social equity.

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Discussants' Comments - 1

Dr. Bhola Nath Chalise
Chairperson
Board of Directors
Rastriya Banijya Bank

The philosophical foundation of the paper presented is the socialism of the West especially those of Nordic and Continental Europe. The socialists in Nepal propound that these countries have reached this level of development through socialism but forget that the foundation of their development was laid by innovative entrepreneurs of the 18^{th} and 19^{th} centuries under capitalism. Modern day socialism in the West has restricted the growth in the developing countries through protectionism, control on free flow of goods, services and manpower globally. While talking about PSD, someone should start with a notion of 'no role for the State in private sector development.' States – be in developed world or underdeveloped – are there to coerce but not to develop the nation. In a typical developing country like Nepal policy interventions are translated into permissions, license, quota, cartel, etc. Implementation of these will become paradise for the nexus of politicians, bureaucrats and business people for corruption and distributing favors to their kith and kin.

Ms. Shakya is in favor of two concepts for 'new' industrial policy for Nepal: special economic zones and export promotion agency (most probably in the Government sector!). The experiences of SEZs have already proved that they are not effective in highly regulated and protected economies like India in the 1980s due to bureaucratic hassles, and they are of no use in an open free economy. Switzerland does not have any SEZ and Hong Kong and Singapore did not care about these. A country like Nepal, which does not have substantial industries to protect, can declare the whole country a SEZ by applying a single rate of 5% tariff on all imports (Nepal has about 10% average tariffs now). Industrialists in Nepal tell in private conversations that the costs involved in getting duty draw back is more than 10 per cent of the amount depending on its scale. They are more than willing to pay 5 per cent tariff rather than wait for more costly duty draw back system. Marketing is a very skilful profession, which needs involvement of highly motivated individuals. Marketing in foreign countries (exports) is still more demanding and costly. How can lowly paid government-appointed officials of the export promotion agencies sell domestic products in international markets?

Ms. Shakya emphasizes the government to focus on labor-intensive policy. From an economist's point of view there are only two types of technologies: efficient and inefficient. Any technology that uses more resources (capital or labor) per unit of product than its competitors is inefficient. If the market is distorted by foreign exchange controls and restricted labor laws, then government needs interventions for labor intensive policies. If the market is left without such distortions, then entrepreneurs themselves will use more labor if it is less expensive than capital.

In Nepal today we have lot more leftists available than necessary. Out of the eight parties active in Nepal six are declared communists and two remaining ones believe that only socialism can bring prosperity here. The dose of extra state interventionist policy will be too much to swallow for a liberal who believes only on a system of individual liberty, limited government and true decentralization. The miniscule of liberals in Nepal have to work hard to face the attack from the Nepali left in the West, especially from the 'full bright Marxist' and the 'Keynesian left'. Forget about attack within Nepal.

Discussants' Comments - 2

Mr. Krishna Gyawali
Joint Secretary
Ministry of Finance

1. While sitting with the computer to write belated comments on MallikaJi's well-articulated and substantial paper on PSD, my eyes caught the following news reports of the day:

- Up to seven hours of nationwide power cut a day which will reportedly continue for at least four more months;
- Garbage dumped everywhere in the city is left uncollected for over a week, over a row between Kathmandu metropolis and the local residents of Okharpauwa in Nuwakot district which is being developed as the primary dumping site; and
- FNCCI says the recent 29-day terai unrest caused a loss of over one trillion rupees to the nation's economy.

This is an indicative ground reality of the country. But this should not deter us from debating and dreaming about New Nepal's PSD vision. In fact, these crises have made people so much aware of the problems and potential of the country's development that it would now be impossible for the policymakers to ignore and dismiss their voices and grievances. Political awakening has led to socio-cultural and economic vigilance of the people, which, if mobilized with supportive policy back-up with clear vision and direction, would help strengthen and sustain political and economic democracy in post-conflict Nepal.

2. The paper rightly stresses on sustainable economic growth as one of the three issues to be addressed in the aftermath of the popular movement and, as a way to attaining this, attaches great significance to PSD. The author's adoption of the three-dimensional approach to analysing PSD issue in Nepal is sensible, in that it has made the paper well-structured and focused. Taking the national scenario into account, her citing the success of BEE in South Africa to offset the trade-off between efficiency and equity is inspiring, though it would require a strong and united government and credible and efficient private sector. The Maoists' economic agenda announced only the other day does not give us a clearer picture as to how they will envision PSD, and their silence on FDI is especially tricky and even discouraging.

3. At the international level, the Paper rightly re-defines the role Nepal can play as a transit point between its two economic giants, described metaphorically as j*holunge.* The paper correctly argues that Nepal can and should benefit from the success of its immediate and regional neighbors, mainly for the FDI and technology transfer, by overcoming the dilemma of policy reversal, and should carefully craft a strategy to optimize its potential through focusing on its comparative advantage.

4. The paper has made a distinction between the 'big' and 'small' pillars of the private sector and argued that the former, rather than the latter, should seek FDI as a supplement rather than the substitute for local investment. The author's suggestion to the policymakers that a 'rigorous national learning system' is required to prevent FDI turning into a unbridled monster is good, but needs to be sincerely followed by the local entrepreneurs and investors as well. Regarding the 'small' pillar, i.e. the MSMEs, I agree with her concept of capitalizing on 'niche' areas to make them look comparatively attractive, rather than seeking unrealistic competition in price and quantity with the neighbors. Her showcasing the notion of 'cultural capital' for Nepal's industrial resurgence is also very convincing.

5. On the whole, the paper is good at exploring and analyzing the issues that trigger the State's role in PSD in new Nepal. It attempts to touch upon many aspects including the role of cooperatives and MFIs as a missing link between agriculture and industries, and cites studies done by the World Bank to highlight how Nepal fares in doing business in the world. The conclusion that the country should now depart from a 'bureaucracy-laden business-as-usual' approach to a 'new and rigorous' strategy should also be taken positively by the PSD policymakers. However, we need to practically sit on the ground and start thinking of what that 'new and rigorous' strategy precisely means. For example, following through a 'linear' approach of policymaking and implementation, we have enacted so many laws relating to PSD (we have scored better than our neighbors in the region on legal front). We have joined WTO much earlier than many of our LDC counterparts and promised to comply with all of the obligations. We have policy pronouncements on PSD in each periodic plan and budget speeches. We have speedily embarked on privatization, with already 26 public enterprises transferred to the private sector. But the impact has not been positive so far at a macroeconomic level although

there has been a sharp increase in the shares of non-agricultural sector in the GDP over the past decade or so.

6. To conclude my observations, if we intend to bring this e-seminar to a practical conclusion, we need to lobby to make sure there are a) a clearly and consensually drafted PSD strategy as a part of the 3-year Interim Plan that is underway in the NPC; b) a stable, competent and professionally sound bureaucracy, especially within the key economic ministries such as MOICS and MOF; c) a credible and confident private sector inclusive but not confined to business associations such as FNCCI and CNI; and d) a stable and liberal political environment. For all this to happen, we should continuously strive for mainstreaming economic development agenda into the political landscape of the country, and let economic agenda receive its due place in the whole scheme of the things. The euphoria that electing a constituent assembly in itself would resolve all problems is misleading and should be wiped out.

Discussants' Comments - 3

Mr. Sujeev Shakya
President
Tara management Pvt. Ltd.

The comments provided are adding to perspectives to private sector development in Nepal rather than providing solution-oriented prescriptions.

Defining Private Sector in Nepal: When we talk of Private Sector Development in Nepal, we ought to first get the definition of private sector in Nepali context examined. Nepali private sector is not a cluster of industrialists or conglomerates, but of individuals, enterprises who have clustered businesses of arbitrage and opportunity. It is not about creating core competencies thereby having competitive and comparative advantage, but more by using strategies that would upgrade the rent-seeking behavior to look like business. For instance, the private sector in the airlines industry does more about leveraging credits on oil, lease rentals and bank credits rather than developing core competencies that can take the airline across the borders. Therefore when they fail, they fail more miserably than the state carrier. Therefore, when we refer to private sector development we need to understand that it is not development of fly-by-night operators who change businesses from cloves to computer hard disks and mobile phones and back to cardamom within a year, but of private businesses that would like to develop competencies to take one's business regional and perhaps global one day. We need to examine the impediments from these perspectives.

The private sector in Nepal suffers from lack of professional dignity. For example, it is hardly believed that an entrepreneur does business to make profits and to offer larger societal contributions. When one launches a hotel project, everyone talks about how much money the promoter is going to make in land transfer and construction contracts, and not how much the project would contribute to employment or tourism. Therefore, it is important to examine development of private sector in the context of businesses that would like to strive to create employment and core competencies along with being able to share their successes by partnering with the general public.

We are in an already confused state of definition of enterprise or of the right of doing business because of the unclear views of the Maoists. P K Dahal, B Bhattarai and company have offered no words for private sector development. If one cannot own land as freehold or get the security over leased land, the enterprises' functions on such land can never be sustainable. Security of land ownership is fundamental right for businesses. Unfortunately, other political parties have nothing better to say too. Erstwhile politicians have only seen businesses as revenue targets who have to be doled favors for the bucks they provide. A *sahu* [merchant] is source of funds for the political parties and an option to get jobs to near and dear ones who cannot be put forced upon government corporations. The business community has also used this nexus beautifully and the *mecca* for business people has been the stage of seminars and workshops where they can hobnob with the politicians. So, starting a trade association and desire of reaching the coveted positions in the associations, chambers and federations have overtaken the hunger for building competencies and business expansions. When one looks at the list of such individuals, one will seldom find any new businesses added by these individuals in the last one decade. Like the worker who would spend his/her time and energy to become a union leader rather than doing a better job and rising higher, the businessman gets stuck in the quagmire of politics.

While it is important that policies as indicated by Ms Shakya be implemented by the government, it is also important to see how the defined private sector graduates to the hunger of business success.

Changing the Thinking

Ms Shakya's recommendation of the writing on the wall of "quality, innovation and export competitiveness" has to be surely taken seriously along with thinking of Nepal as land-linked rather than land-locked. Nepal needs to have its own Havana Cigar or Swiss Chocolates or watches that identify us with the product. With a pseudo-militant labor force, it will be difficult to run industries with large deployment of human resources. Therefore, clusters of small 'niche product' producers can go behind a brand that is managed by an international firm with the competencies of doing so.

Regarding the statement highlighted in the paper that co-operatives could be the missing link, we need to again redefine co-operatives. There are more than ten thousand co-operatives currently operating in the financial sector in Nepal, but very few of these seek broader integration of financial services and access to finance. Most of them tend to stay out of the ambit of the regulations of the Nepal Rastra Bank. Some of these co-operatives are promoted by 'pillars of the Nepali private sector' and larger than finance companies. We need to therefore get a bit specific when we look for definition of the 'genuine co-operatives'.

Looking at Private Sector through the eyes of Private Sector

Non-private sector institutions have done successive studies in Nepal on the private sector. To take an example, in India the Confederation of Indian Industries (CII) has conducted many studies and institutions, e.g., NASCOM has changed the face of IT business in India. Unfortunately there are no studies on the private sector done by private sector institutions in Nepal. This void has made understanding private sector development difficult. Further, with most of the good human resources in Nepal being attracted by development agencies rather than private sector (directly contrary to what happens elsewhere in the world), there is a serious lack of capability within the private sector to think of development of the sector. We have bilateral and multilateral organizations whose objectives are not doing business, but which advise in their own way how businesses ought to be done; that has also created much confusion. Perhaps, the multi-dimensional agenda that Ms Shakya has raised in her paper needs private sector champions to take the ideas, test them, and put to fruition.

In conclusion, many people disagree to the concept that to tackle poverty, wealth has to be created. But this may be the only option left for a country that has seen violence, exclusion and social disparity. The creation of wealth is the business of private sector and as Nepali private sector graduates from individual 'myopic *sahus*' to largely held efficient global businesses with many constituent shareholders we can look at reducing poverty to a large extent in the emerging Nepal.

Discussants' Comments – 4

Dr. Vijaya R. Sharma,
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In this note I focus on the need of strengthening the role of the private sector in export and investment promotion and in technology and skill development programs. Since the economic liberalization that began in 1992 with changes in industrial policy, foreign investment policy, and trade policy, governmental and semi-governmental agencies have been entrusted the tasks of promoting exports and industrial investment. Private sector agencies like the Federation of Nepalese Chamber of Commerce and Industry (FNCCI), the Chamber of Commerce, the garment manufacturers' association, and the carpet manufacturers' association have barely been given any significant role. Their representation in Trade Promotion Board, Industrial Promotion Board, One-Window System, Industrial Enterprise Development Institute, and National Productivity and Economic Development Center is either nil or minimal.

Reforming macroeconomic policies and improving business environment are important, but also important are the functions of disseminating information on business climate, exploring and developing export markets, providing services to potential investors and exporters, and advocating and lobbying for policy changes. Experiences of countries like Hong Kong, Singapore, Malaysia, and Ireland suggest that these functions are likely to be more efficiently executed by private sector agencies than governmental agencies.

The private sector is the final user of the services of promotional agencies, and it more intimately knows the dynamics of the market. Therefore, relative to private sector, governmental and semi-governmental agencies are likely to do a poorer job of identifying the areas, sectors, and products that need to be prioritized for optimal allocation of budgetary expenses for export and investment promotion. Also, governmental agencies have to operate within government rules that lack the necessary flexibility of quickly adapting to changes in market conditions. An even bigger limitation of a governmental agency is its work culture; the officials tend to behave more as regulators than facilitators. There are often inter-agency rivalries and clashes among government line agencies on perceived encroachment of authority of one agency by another. The above limitations adversely affect the efficacy of promotional programs run by governmental agencies.

It may be desirable to create a privately run institution for export and investment promotion. To make such an institution effective and credible to the prospective investors and importers, (1) the institution needs to be constituted under a separate charter, (2) it should be led by a reputed person from the private sector who is appointed by the prime minister, (3) its board of directors should compose of representatives from private sector trade and manufacturers' associations and from related governmental agencies, (4) it needs to be supported with grants from the government, (5) it needs to have a periodic oversight of the government in the form of representation in the board and in the form of financial and performance audits, and (6) it needs to be permitted to charge fee for its services. Such a proposal will necessitate reconfiguration of institutions like Export Promotion Board, Trade Promotion Center, Industrial Promotion Board, and One-Window System.

Nepal's manufacturing base and export products are characterized by a very low technological level of production. There is almost total absence of firm-based skill or technological development programs. There is also an apparent mismatch between the needs and demands of the industrial sector and programs of various governmental agencies that are engaged in science, technology, and skill development, like RONAST, RECAST, Food Research Laboratory, Royal Drugs Research Lab, skill training programs of the Department of Labor and the Department of Cottage and Small Industries, etc. A three-pronged approach may be necessary in this regard: (1) Provide incentives to firms for targeted and in-firm skill development, apprenticeship, technology adaptation and innovation. (2) Involve FNCCI, subsector associations, and private industry on planning, designing, and developing schools and training programs for generating middle-level technical human resources, by enrolling high school graduates and imparting them one and two-year courses that are directly applicable to the industry. Nepal may learn from experiences of other countries like Chile. (3) Facilitate import and transfer of technology and conduct programs of productivity improvement through FNCCI and/or industry associations.

Finally, in the light of fact that Nepal is embarking on a federal system of governance, some of the functions of the central government may be transferred to provincial governments. Such likely functions could be the above-mentioned in-firm skill development programs, the technical schools for mid-level technicians, and also policy issues related to agriculture development and land reform.

Discussants' Comments – 5

Prachanda Man Shrestha
Joint Secretary
Ministry of Industries, Commerce and Supplies

On the economic agenda of Nepali political leadership:

- Certainly, private sector development is one of the most relevant and pertinent issues, especially in the present context that Nepal going through a major turmoil brought in by the popular political movement. We, therefore, have to assess this topic in the context of the agendas brought forth by politicians in their endeavours of State-building and restructuring.

- As mentioned in the paper presented, Nepal has witnessed three major political movements within half century but there still seems to be uncertainty on the policy measures needed for an economic delivery. FNCCI's stand was weak throughout the recent April movement, and it lacked clarity over whether it was supporting or opposing the movement.

- The reason for such a lack of clarity could be two-fold: First, the Nepalese private sector was reluctant to embrace the dynamic changes and they seemed to prefer to cling on to the privileges they received in the *status quo*. And second, the political leaders have not been driven by the economic agenda and they lack conceptual clarity on the role of private sector in the process of State-building.

- The aftermath of the past political movements have shown that the politicians tend to prioritize short-term, populist, and vote-bank-oriented policy actions over longer-term sustainable productive systems aiming to encourage private sector investment boosting economic growth.

- This makes it very clear that the sustainability of peace with political stability in the country depend largely on the national consensus on the universal question of equity versus growth. In Nepal, the equity argument has been put ahead of growth, owing to policymakers' adherence to popular political slogans at the expense of rational policy manoeuvres.

- Therefore, this time, for sustained peace and stability to institutionalise in the country, economic growth is to be made the primary agenda in State-building and in strengthening of the economic system alongside equitable distribution. Private sector development can and should draw needed attention of policy makers.

- A compromise between growth and equity can only be the creation of employment in the country. Therefore, all the national policies must be directed in an integrated way towards creating jobs in all segments and all tiers of the society – be it in manufacturing, services, agro-based industries or technology-based activities. The policy choice should neither be merely between labor-intensive or capital-intensive, nor between domestic or foreign investment, nor between large-scale or small-scale enterprises.

- In the same way, we should not keep on doing the merry-go-round in the name of inclusiveness and exclusiveness but create and provide works and jobs for all Nepalis in all parts of the country enabling all to be economically productive. Economic engagement for their share of return to uplift their standard in life is to be the bottom-line of any policy discourse.

- Particularly after the failure of command economy, it is accepted globally that business is not to be done by governments. Governments have several other roles to take. Non-government agencies doing business for profit are the private sector. Therefore, government's responsibility of economic growth is to be discharged through the efficient functioning of private sector. Government must succeed in getting the desired outcome of economic growth through private sector performance. The only instrument left for the government in this direction is through the pragmatic policy strategy and its effective enforcement which are reflected in the form of:
    - regulatory and institutional mechanism to guide, control and monitor the private sector business,
    - incentive provisions to encourage private sector for investment, innovation and overall entrepreneurship,
    - supportive measures creating physical infrastructures, negotiating for external market access, promoting for market opportunities,
    - facilitative measures for access to capital, technology, and skill

- protective measures for risk minimization and competitiveness through macro-economic stability and enabling environment.

Therefore, the role of government in delivering economic output is relatively indirect and requires respect for the market mechanism. It has been obvious in getting priority of social agenda over economic agenda in countries of poverty and deprivation including Nepal.

On technical aspects of the private sector development strategy:

- The private sector in Nepal is still at the primary stage of development from the perspective of corporate culture and management, and not very well organized for a strong and coordinated advocacy to influence the State policy. Private sector consultation and input for policy formulation are still *ad hoc*, uninstitutionalized, and voluntary. Therefore, the Private Sector Development Strategy, first, has to take into consideration institutionalization of the consultation process in economic policy formulation in order to build confidence among the private sector actors.

- Private sector development needs stability in state policy particularly at macro-economic and sectoral levels in order to let the investors feel safe on their investments and reliability on the incentives. Due to political instability in the country during the past, credibility of the State has substantially eroded. The new leadership is bound to face some challenges in regaining credibility when they will announce their new policies irrespective of its merits.

- Although majority of people in Nepal are engaged in agricultural farming, they have not yet been able to consider themselves as being in business or being entrepreneurs. The farming activity is long considered more of a livelihood activity than a commercial or entrepreneurial activity. A private sector development strategy has a critical role in recognizing the importance of a major force within the private sector. There is a large scope for developing a major program in the agricultural enterprise sector that would develop regular business support services as well as specialized institutions offering services on hedging, grading, cleaning, packaging, and labelling.

- One more step is the support in adding intangible value based on ethno-culture-heritage and geography both in agro-based and industry-based products from Nepal to fetch prime price in regional and international markets. I fully agree with the paper that Nepal's comparative advantage lies on niche products. However branding such products for premium price in external market is beyond the capacity of domestic private sector. It is where the strategy must focus on the role of multi-national companies that would help establish global linkages that would usher in the benefits of globalization.

- State role is still very much needed in Nepal in investing in a massive way in building physical infrastructure, particularly transportation, communication, and energy. Without cost-effective availability of these basic infrastructures, the private sector cannot be competitive in production.

- Nepal's geographical location between the two fastest growing largest economies of the world means that the policy strategy has to especially focus in benefiting from the economic spill-overs from the process of economic integration between China and India, which is bound to take place as they consolidate the sustenance of their growth. Nepal's strategy should be to make use of the cross-border integration even in the production processes, e.g., flow of goods, services, technology, and investment. This can be achieved through a closer integration of the Nepalese private sector actors with those from China and India. The brand of Himalayan products could be of great interest to both China and India, where they can share the supply and value chain as per their individual comparative advantages and market absorption capacities.

- In the context of Nepal's recent popular movement, awaiting the formation of the interim government with participation from all parties including revolutionaries, private sector development heavily depends on the state guarantee to protect domestic as well as foreign investment and role of political parties in balancing interest of their trade unions to the comfort of investors in business enterprises for their competitiveness.

Discussants' Comments – 6

Mr. Jagadish Upadhyay
Independent Consultant
(Retd) World Bank

Ms. Mallika Shakya's paper aims *to identify pertinent issues that must be addressed for a PSD strategy …..at this transitional situation ….NOT to offer solutions*. This note summarizes my views on the most important issues and opportunities.

The Background

Nepal experienced significant all-round improvements in economic and human development between 1995-96 and 2003-2004. The incidence of poverty fell from 42 to 31 percent. Health and education outcomes improved, particularly for girls and people living in remote areas[2]. Such findings, of the National Living Standard Survey of 2003/04, show that Nepal made considerable economic progress even during the twelve years of conflict. However, Nepal's economy grew only by 2.7 to 3.8 percent between 2003 and 2005, compared to 7.7 to 7.9 percent average for South Asia, and by the declining rates of 2.7 percent in 2004/05 and 1.9 percent expected in 2005/06.[3]

The recent peace accord with the Maoists provides new hopes to move ahead more vigorously. Most countries have accelerated growth through private sector development (PSD). What are the main hindrances and the opportunities for Nepal?

Main Issues

Political Factors. Conducive political climate is a fundamental prerequisite. Ms. Shakya's paper recognizes this but seems much more optimistic than might be warranted. The Maoists' participation in competitive politics could prove to be a HUGE wishful thinking. The first question is how will the Maoists behave if they lost the next election considering that they went to the jungle when they lost the last time? Secondly, what will be the Government's attitude if Maoists came to power or shared power in a coalition? The Maoists have been openly

[2] *Resilience Amidst Conflict*, the World Bank, Asian Bank and DFID, 2006.
[3] Economic Survey 2005/06, Ministry of Finance.

announcing that the agreement with other parties was only a stepping stone to achieve a full-fledged communism. Their leaders have denounced private ownership of properties. Will a Maoist Government behave like the Chinese, the West Bengal Communists or the Cubans? Will there be other possible political conflicts, like the recent Madhesi protests?

Institutional and Governance Factors. A recent story in the Economist (February 3-9, 2007) starts as follows: *Once upon a time, not so long ago, there was a poor continent. Its name was Europe. Then it discovered three things: the free market, the rule of law and science-based technology. Now it is rich....simplistic perhaps, but the same thing happened in North America, with the same consequences, and it is now happening in Asia...*

Ms. Shakya cites that Nepal ranked 100 out of 175 countries in Ease of Doing Business Index. The Government too admits that: Investments could not be attracted due to lack of legal and institutional framework for the protection of investments, inflow and repatriation of capital, flexible labor policy, and standard accounting and auditing system in place for ensuring good governance in the private sector4.

Nepal can radically alter the situation and stand out in the area. All South Asian countries lag significantly in dealing with private sector. Nepal, as a smaller country, has advantage over larger countries. India's experience can greatly help in developing institutional framework or rules. I wonder if an internationally participated watch-dog body could be established in Nepal to guarantee efficient implementation of a trustworthy PSD mechanism which will be fair and completely free from red tape. This could provide Nepal with that "niche factor" needed to compete in the global market, attracting entrepreneurs from India and other countries. (Of course, there could also be other potential niche products like hydropower, tourism, tea, herbs, etc.)

India/China Factor. I agree with Ms. Shakya that Nepal could benefit immensely by acting like a *jholunge* [bridge] between two economic giants, shining India and roaring China, instead of maintaining the old thinking of *yam between rocks*. Nepal could largely meet her quest for FDI and technology transfer without turning too far. But Nepal must make efforts to maximize FDI and technology transfer through smart

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[4] Economic Survey, 2005/2006, Ministry of Finance.

fiscal policies, no red tape PSD environment and continued good economic relationship with neighbors. For example, competing with India will be more difficult in most areas but Nepal can involve influential Indian entrepreneurs in her private sector and use their goodwill to preserve Nepal's interests just like US traders lobby for overseas suppliers.

Manpower Export. Manpower export and remittances will continue to be extremely important for Nepal for the foreseeable future. This is important for employment, income generation for relatively poor populations, to meet Nepal's balance of payments and for the liquidity needs of the economy. This can also prepare workers for more productive work when they return. In recent years, manpower export to third countries (other than India) has grown very significantly, especially to the Middle East and East Asia. The remittances have grown from 3 percent in 1995/96 to over 12 percent in 2004/05. The following data <u>during the first eight months of 2004/05</u> demonstrate the importance[5]:

Workers remittances:	NRs 36,060 million
Gorkha remittance:	NRs. 1,996 million
Total goods export:	NRs 36,948 million

Export of manpower must, therefore, be facilitated properly through the establishment of training facilities to enable better income, through improved recruitment management to prevent exploitation by bad contractors, and by establishing efficient and trustworthy remittance facilities to prevent cheating by unscrupulous middlemen.

[5] Economic Survey, 2004/05, MOF.

Discussants' Comments – 6

Dr. Mukti P. Upadhyay
Associate Professor
Economics Department, Eastern Illinois University

Many minds in Nepal are occupied, and rightly so, with the question of how to reorient political structure in the country. Sustained economic development requires a stable political system. Meanwhile how to create a durable basis for development in the new Nepal must also be thought through. It is refreshing to see Ms. Shakya thinking about development of the private sector in new Nepal in this context. There is a serious concern in some quarters that the Maoists might succeed in acquiring much of political power after a new constitution is written and a new election held. In that case, the argument goes, the role of the private sector will be severely curtailed. We continue to hope, on the other hand, that democracy is here in Nepal to stay. What role should the private sector then have in development? In particular, how should things change from the way they are now?

There is a lot in this paper with which I agree. Here, however, I focus more broadly on a few things that I think need further elaboration and emphasis. Is the model of development Nepal has been trying to follow since 1991, for instance, an appropriate one for future or does it need a major change? In the dimension of private sector economic activity, I do not think that the broad contours of the existing model need a fundamental transformation. This includes the rights to private property. A new model will have to change, however, in the way it addresses gross inequality of political and economic power existing today. The heightened awareness of the plight of the poor and underprivileged makes it almost mandatory for the state to provide them some support and enable them to exercise their political rights.

The paper proceeds with the presumption that the new government will drop all hostilities to the private sector. During the period of transition to an evolving new order, I feel it needs repeating that having too many regulations and controls will stifle private business. Nepal made major advances in the early 1990s to emphasize clearly that it is individuals and businesses rather than the government that would serve as the engine of growth. Reducing the regulations and protection of inefficient import-competing industries were some good examples of the policies taken at that time. Carrying this perspective forward would seem to be essential.

As an example, greater labor market flexibility may be required to boost growth of private investment. Yet it may be particularly difficult to relax labor laws in Nepal if social demands to protect poor workers from “unscrupulous” businesses are carried too far. This is one of the important issues that policymakers in India have also not been able to resolve. To get around the prevailing labor and tax regulations, many developing countries have set up free trade zones (FTZs) or export processing zones (EPZs). Malaysia, China, and Kenya are but a few good examples of significant growth through EPZ manufacturing. Development of infrastructure and accumulation of human capital in local labor are some of the prerequisites for attracting foreign direct investment (FDI) in EPZs and, more strongly so, elsewhere in the country. Nepal may have a long way to go in that direction. But sooner the country realizes that a thriving industrial sector is not feasible without FDI in the country’s low cost resources, the better. One can simply look at Mauritius, a country that was termed a case of Malthusian trap at the time of independence. By early 1980s, the open trade and investment policies, and tax preferences were combined with the maintenance of near equilibrium exchange rate and the removal of special favors given earlier to public enterprises. By the mid-1990s, Mauritius had emerged as the seventh in a group of 15 consistently growing exporters of manufacturing among low and middle income countries, outperforming such stellar exporters as Thailand and Portugal.

Going back to basics, a problem that must be tackled by the new government in Nepal is how to reduce uncertainty and encourage risk-taking. Much of institutional evolution necessary for efficient management of risks is a slow process. For example, breaking the status quo can be difficult in any regime including democracy. Indeed, windows of opportunities for a rapid change may be available sometimes. A new government formed after a large victory in elections can often go in that direction. Yet political leadership may be loath to make such a move. The people that advocate transparency in government during elections may fall for personal gains to be made from the continuation of old policies. The problem is that situations like this can create or sustain uncertainty that becomes hard to remove for a long time.

Uncertainty dooms growth by constraining investment. It is usual for firms to work with risks in business because often the probability distribution of returns is known or can be estimated. Uncertainty, however, takes away much of the basis on which decisions can be made. During the Panchayat regime, removal of uncertainty in industrial and commercial policy was a regular demand of the business community. Yet the groups that controlled political power had no incentive to remove the status quo. This shows once again that we must start raising transparency in government to align the private incentives of rulers with public interest. Once again, we must reform institutions to emphasize administrative and legal efficiency to go along with the soon to be established political superstructure.

The paper indicates how Nepal can profitably concentrate on the production of “smart” goods such as specific types of garments. The need is to identify many more of the goods that reflect current comparative advantage, either based on an abundance of specific resources such as unskilled labor or some natural resource. A WTO study describes how a recent experience of a herbal medicine company in Nepal, Gorkha Ayurved, has shown a critical need for quality assurance which the government regulatory bodies must establish to increase access to export markets. As is well known, Nepal should have a clear relative advantage in medicinal and aromatic products because of its rich biodiversity. Improvements in quality standards and FDI inflows in this industry could help to capture a share of the rapidly growing world demand in this market.

For long-term development of the country, however, what matters is the emergence of new products and processes that indicate dynamic comparative advantage of the country. Such products are hard to predict years in advance. Thus, rather than intervening in the product markets directly, policy should be geared to creating an environment where the risk-taking ability of entrepreneurs and the productivity of workers can increase on a sustained basis. That probably is the only way to escape productivity stagnation that is bound to set in gradually in many of the goods in which the country has comparative advantage today.

Attracting large FDI is difficult in Nepal in the short run. Why not invest more in exploring large FDI inflows from India? Of all the foreigners, the Indians are in the best position to take advantage of opportunities offered by Nepal’s economic and non-economic resources and policy. Investors from India will also have easier access to the vast Indian market for Nepal-made products. Finally, FDI from India should also help in giving signals to third country investors about good investment prospects in Nepal.

Turning inward, what can the country do in its domestic sectors? The services have grown much more rapidly in Nepal than sectors producing goods. Expansion of finance, health, and education mainly in the urban areas has been a leading factor in the growth of services. Though hit sharply by political instability, tourism still holds immense potential for growth once lasting peace returns. The poor investment climate in industry has made trade more lucrative than manufacturing where investments are lumpy and returns may be uncertain. This is not, however, a problem because if growth through private investment is a main strategy of development, funds will flow to wherever the expected return is high. It is the job of policy to reorient the incentive structure, and to reduce the risks involved, if possible. But the policy should reflect long-term development priorities and should only change when such priorities do.

Can Nepal arrive at a political consensus on pro-business policy that consistently encourages the use of abundant national resources? Malaysia, Thailand, South Korea and Indonesia prospered since the 1960s not because they all adopted authoritarian regimes for decades. Their progress owed much to a powerful hand of the state that provided basic infrastructure, and guided and nurtured private investments.

Review from the floor

Keshav Acharya
Chief Economic Advisor
Nepal Rastra Bank
(currently working at the IMF)

Nepal's economy holds tremendous potential in the long run, among others, in bio-diversity, hydro-electricity and tourism.

For any meaningful, comprehensive and sustainable transformation of the Nepali economy, one should begin from agriculture where nearly 21 of the 28 million Nepali people depend for their livelihood. In the last 10 years, Nepal's traditional farm production such as rice, wheat, pulses and oilseeds have been almost displaced by Indian production for the following reasons:

a. India is in the process of completing its second generation of green revolution, whereas Nepali farming practices remain traditional even today. This has created a huge productivity differential between the Nepali and Indian food production. As such, given the open border, it is quite natural for the Indian food grains to substitute Nepali produce.

b. In the process of liberalization, Nepal has withdrawn all forms of subsidies from agriculture, whereas India continues to heavily subsidize the use of chemical fertilizer, seeds, electricity, diesel, farm credit, extension services, and railway and sea freight for farm produce. Furthermore, India is accelerating public investments on infrastructure such as irrigation, rural roads, rural electrification, and extension of railway connection to rural India. In Nepal public capital allocation for agriculture is subsequently declining. Naturally, competitiveness of Nepal's agriculture is successively eroding.

c. Yet, there are lots of prospect for Nepali agriculture. The prospect lies in the rich bio-diversity of Nepal. The inflow of Indian FDI in the form of Dabur, Hindustan Lever and a few others is a clear indication of this competitive advantage of Nepal *vis-a-vis* India. What the state needs to do is to inject sufficient investment on infrastructure such as irrigation, electricity and road or cable car connectivity, by mobilizing donor support; and enforce the property rights.

d. In the last several years, there has been a massive build-up of infrastructure in Tibet and a tremendous increase in Tibetan

> purchasing power. If Nepal endeavors to supply the food demand of Tibetan consumers, it can transform the livelihood of Nepal's northern hills and mountains; it requires the provision of infrastructure and technical know-how.

The talk has been going on in the last couple of years to develop Nepal as a transit corridor between India and China. The geographers and engineers have advocated that there are several prospective road projects which can considerably narrow the distance between these two fast growing countries. Given the rapidly growing trade flows between the two giant economies, the Nepali authorities can approach these neighboring countries to invest on mutually beneficial road projects through Nepal. Such road connectivity would also help to explore the possibility of developing pasture in Nepal's northern highlands, which in turn would support sheep farming which would substitute the import of raw wool, for making carpets and pashmina.

Nepal Government's Department of Mines and Geology needs to undertake a massive survey to find out which gems are available in commercial quantity. After this, the Government will have formulated laws, rules, and regulations governing extraction, processing, and export of gems and jewelry by the private sector with international joint ventures.

Provision of infrastructure and public utilities is too costly in hills and mountains, as compared to terai and the valleys. There should be inducement and incentive given to people to resettle or conglomerate in areas that are wide enough and free from geological and other natural hazards such as land slide, from the perspective of cheaper cost of providing modern basic amenities of life. Furthermore, such resettlement would create space for private sector in terms of construction and repair.

Regarding development of private sector in Nepal, the Nepali authorities have mostly played on tariff differential or arbitrage with India. Goods imported to Nepal were illegally smuggled into India against the payment in Indian Currency. Such a trade policy generated customs revenue and brought Indian currency into Nepal and offset the trade gap with India. Things have changed now. India is fast lowering its tariff structure to allow no space for arbitrage in Nepal. Now is the time for Nepal's private sector to look into the country's long-term comparative advantage. In this context, the following things need to be done to facilitate the development of private sector in Nepal.

a. Provide macroeconomic stability, particularly in its fiscal and monetary policy. Have political consensus on not making frequent changes in the rate of tax. It is right time for the economic policy agenda to get space in the debate on constitution. As there is a general drift towards federal structure of government, the constitution should clearly spell out the basis of resource sharing between the federal and the provincial governments.

b. The constitution should layout the blueprint categorically for the space of state and the area for public private partnerships, so that the private sector can plan its activities accordingly.

c. Private enterprises of certain size and above should be made to follow nationally defined accounting standards and disclosure norms for increased transparency of financial statements, and there should be some mechanism to constantly monitor to increase public investment in stocks.

d. The private financial sector is urban centric. In the rural area there is a very thin and sparse presence of financial services, especially in the hills and mountains. Some intervention seems imperative in expanding financial services to rural areas in general and in the hills and the mountains in particular. The preferred nature of intervention would be budgetary and tax incentives, rather than the government itself operating financial services.

e. Since the last few years, annual remittance inflows have exceeded the combined total receipt from exports, tourism, and foreign aid. But, the contribution of remittances is confined to sustaining consumption, imports and somewhat real estate investment. There should be a plan to pool some resources from remittances for undertaking productive investment in areas such as hydro or microfinance with full legal guarantee of returns to the remitters.

f. There has been a tremendous proliferation of bank and non-bank financial institutions in the urban areas, which puts a limit on the supervisory capacity of the central bank. There is an urgent need to set up a second tier supervisory institution and also a need for some kind of self-regulation of these institutions.

g. Nepal should reorient its focus on the development of self-regulated cooperative societies and microfinance institutions in the rural areas, with some kind of initial budgetary support.

h. To reduce the cost of operation of financial services in rural and deprived areas, rather than opening a new branch or a full-fledged institution in such areas, one can look for a local agent, train him and assign him with the task of lending and recovering for a certain fee.

i. Finally, one can also look into the prospect of formalizing, organizing and consolidating the informal financial services that have been in existence in Nepal since time immemorial into modern type of microfinance institutions, without much financial and bureaucratic cost.

A Summary of the E-Seminar Floor Discussion

The paper presentation and designated discussants' comment was followed by a virtual floor discussion among the participants. The discussion has been rearranged thematically and follows an ascending date order (i.e, older postings first, followed by new postings). The major themes are listed below. A list of participants can be found in the annex:

1. PSD in a political context
2. Big pillar: Hydropower
3. Small pillar: MSMEs and the business environment
4. PSD, human development and social issues

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1. PSD IN A POLITICAL CONTEXT

Maoists have not clarified their vision and economic agendas, but some of their initial priorities and positioning have begun to emerge.

Nepal has indisputably experienced a shift towards left in the political balance of power, with the emergence of the Maoists as a big political force. In the changed political context, the designated discussants have raised concerns that the mainstream political parties, especially the Maoists, have not clarified their vision and economic agendas for the New Nepal. Will the economic liberalization that began in 1992 continue? What would be the parties' approach to private sector development?

What direction should the private sector development (PSD) take in Nepal, especially on the general pitfalls that Nepal should avoid in the areas of protection of private property rights, treatment of FDI vis-à-vis domestic sources of investment, the issue of social and gender inclusion in private enterprises, level of protection of domestic industries, and promotion of competitive business environment?

(Vijaya Sharma)

The Maoists have outlined their economic agenda and the corruption control has become one of their priority fields, to be followed by the radical land reform, and the regulation of the FDIs. Like everyone else, they also see hydro and tourism as our comparative advantage. They also profess a mixed economy, but with a protectionist flavor.

(Alok Bohara)

This article in Nepal Weekly by Rishikesh Dahal might be of interest to the participants on Maoist vision on PSD for New Nepal: http://www.kantipuronline.com/Nepal/artha.php

This article reports that the Maoists commit to: (i) a mixed economy with individual rights to profit; (ii) transparency and corruption control; and (iii) revolutionary land reform (including scaling/upgrading of co-operatives). Sectorally, they seem to have picked up hydropower and tourism as potential growth-bearers and connectivity (e.g. an ambitious east-west highway in the Mahabharata region) as a primary developmental goal on PSD. This shows signs of welcome pragmatic improvisations on Baburam Bhattarai's 'red' vision twelve years ago. 'Old wine, new bottle' might be too much of an expression, but save some logistical differences in modalities, a Maoist PSD agenda might not really be 'the new broom' either, which should actually leave policymakers a small space for policy maneuvering in the coming days.

(Mallika Shakya)

Unfortunately, the Maoists have said different things to different audiences and in different forums. Therefore, while we should hope for the best for PSD and for overall economic growth development following the experience of other countries, "policy uncertainty" should remain as an overwhelming issue until we see convincing evidence of their policy.

(Jagadish Upadhyay)

I agree that there is policy uncertainty regarding the Maoists' vision, but I disagree that this should remain an overwhelming issue. Should this ambiguity not allow the policymakers a good pretext to assert their vision before they are pre-empted by either ultra-leftists or ultra-rightists? It is absolutely right that a debate on Maoism-vs-Capitalism is a non-starter. However, if we go a step below, it is not so black-and-white. It is largely about technical coherence of institutions, regulations, and incentives. For example, if we want to develop niche products, which have been our competitive advantage throughout both Panchayat and Bahudal; the recipe does not necessitate a philosophical debate on left-vs-right. It is about ensuring that we develop effective certifying and market promotion agencies; avail appropriate financial instruments for transactions to happen; develop provision of backbone services; allow collaboration/innovation economics; develop a smooth supply chain.

(Mallika Shakya)

Federalism is a rapidly emerging issue and PSD strategies will have to take stock of this discussion

The federalism issue is quite complicated in the current context and any link to the PSD will be overshadowed by numerous other contentious issues. It is the institution that makes a long-lasting difference in the making of a nation and the people. That is, federalism is not the only real issue; the problem should also address the degree of centralization/decentralization including both the political and economic. One of the issues that I have raised constantly is the issues of revenue sharing 50/50 from the hydro resources. Giving some economic clout to the regional governments is a good start. But, such revenue must not be spent anything other than education, health, and the infrastructure.

A complete version of my article on federalism is linked to the following website as a February 26, 2007 attachment:
http://nepalstudycenter.unm.edu/SeminarsWorkshopsConferences/e-Seminars/e-SeminarN012007/ e-SeminarNo12007_PaperAccess.html

Also, it may be worth reading the following interview with Mr. Yash Pal Ghai: http://kantipuronline.com/kolnews.php?&nid=101887

(Alok Bohara)

2. **'BIG' PILLAR: HYDROELECTRICITY**

(a) WHO ARE THE INVESTORS?

First few projects have set a bad example.. …

Nepal has seen the inflow of foreign direct investment (FDI) in the sector of electricity generation (the 60mw Khimti from Norwegian Statkraft and the 36mw Bhotekoshi from Panda Energy of USA), and this has vitiated the market in such a way that FDI in power sector has now become an anathema. They have been instrumental in raising retail electricity rates to the extent that a further rate increase would never be politically acceptable. If, however, the retail rates are not raised, the Nepal Electricity Authority (NEA) would go into financial bankruptcy.

(Keshav Upadhyay)

Funds may be difficult to mobilize ….

So far as FDI in the power sector is concerned, everything that Ms. Shakya warns against has happened here. It has distorted the price, and is neither cost effective nor market friendly. NEA is very apprehensive of entering into new power purchase agreements because of its bitter experience in the past. Therefore, not enough investment from the private sector is coming into this sector. NEA has been continuously in the red for half a decade now and is, without a surplus, not in a position to invest. The government, on the other hand, does not treat electricity as infrastructure but rather as a commercial commodity, and recent utterances of the finance minister confirm this. The only option that remains is the national private sector, which is also hampered by archaic rules and regulations unfriendly to investment.

The size of investible funds may be difficult to mobilize. My estimate indicates a figure of nine billion rupees that must be invested annually to meet the rising demand of 60mw per year. Is our banking system capable of lending this amount of money where the return on investment starts trickling in only after five years at the least? Meanwhile the country is reeling under a severe power crisis leading to a blackout of six hours per day for we don't know how long.

(Keshav Upadhyay)

Talking about hydropower and bashing Independent Power Producer's Bhotekoshi and Khimti has become nation's favorite pastime. All the people who earned donor dollars to crib against the private developers in the past ten years could not suggest alternatives; therefore, Nepal is back reeling under power shortages. While we talk of private investment in hydropower, we talk as if we have zillions of people lining up to invest in Nepal. Contrary to that, it is difficult to find investors in the hydropower sector. Only 15 hydropower projects have financially closed in the past decade and a half out of which two are in Nepal. Price is determinant on cost of production. Nepal is not credit rated and therefore getting financing for Nepal is utterly difficult. When the financial closing for Bhotekoshi was underway, 63 banks rejected the proposal despite being led by a multilateral like IFC and had a dollar based PPA. The guarantee of countries like Nepal which people presume to be part of selling national sovereignty is a piece of paper and many guarantees globally have been meaningless.

(Sujeev Shakya)

SujeevJi is right that there are not many possible investors and we should give every opportunity to those who really want to invest in hydro power in Nepal, but there are about fifty applications pending in NEA for Power Purchase Agreement (PPA). Developers are running from pillar to post for PPA. Nothing happens. Recently I had an opportunity to go to NEA to discuss with NEA people about the energy rates for a hydropower project to be developed. Apparently there is a glut of investors.

(Keshav Upadhyay)

Good enabling environment is a prerequisite in invoking competition so equilibrium can be reached. But there is nothing that says that competitiveness deteriorates as soon as foreign aid is received. Other countries seem to have maintained such competitive local environment even when mobilizing donor-grants or subsidized-credit. This has been successfully experimented in several East Asian and Latin American countries. A good technical specialist can develop such modality in Nepal's context too. Nepal's decision to go straight to commercial investors is good but one only hopes that this was done only after exhausting more pragmatic options.

(Mallika Shakya)

Donor money has failed us …

Perhaps, Nepali hydropower have not been able to take off as the people who think they have solutions for this 'business of hydropower' are not investors, but people who continuously make it an issue to study and compile reports and do workshops. They can point out what is wrong but not come with a concrete solution. As I mentioned in my earlier deliberations also that such people for the past couple of decades belching different formulae have landed Nepal into darkness.

The issue is of action and taking risk! Perhaps apart from the private sector there are none to take this 'risk' as they look for the reward for the institutions unlike the 'rewards' that public sector projects bring to individuals who are bestowed strategic positions. If Nepali hydropower is to be harnessed, the options are either to take grants and deliver expensive projects to the economy and create more debt on the average Nepali, or to allow private entrepreneurs to take risk and get it going with at least one project. Else even in 2017 we will still be having the same deliberations now that are not different than what we were having in 1997!

(Sujeev Shakya)

I do not agree that donor aid and FDI are a trade-off. The European infrastructure model of the 1950s and the East Asian infrastructure model of the 1970s have one thing in common. They both mobilized donor credit (i) to set up market-efficient models which dissected public goods from private, and awarded commercially-managed contracts to competitive private bidders; (ii) to invest heavily on technology/knowledge-transfer as the projects proceeded; and (iii) to subsequently graduate from the donor credit by replicating the models internally for future ventures. Besides, more of Nepal's donor debt seems to come not from mega-infrastructure projects but from something less ambitious. And the rest comes from paying for IPP-power that was never consumed.

I also do not agree that academics are a waste of time. Negotiation in big projects will come from number-crunching, than from lobbying/*linde-dhipi* or abstract philosophizing. I am always impressed to see the academics in UK and US, for example, coming to aid of the governments in bargaining with the private sector. Nepal might be only beginning to wake up to it, but it is better late than never.

(Mallika Shakya)

Partnership with India is an attractive option but increasingly sensitive and inextricably webbed with foreign policy issues …

In Nepal's case, hydropower sector is not a normal industry. It has deep security implications. In fact, this sector has been the bone of contention between India and Nepal for a long time. Many in Nepal feel it is the only tangible and realistic potential we have for our economic development. Nepal does not want to give that up so easily, but use it towards leverage whenever we wish to bargain with India. This psychology has cost us money and time, as the water continues to flow without being tapped for power.

I remember what Chandra Sekhar told a group of prominent Nepalis in the 1990s when he was the Indian Prime Minister. His statement was something like "I heard about your hydro potential and India's power need when I was a teenager, I heard the same thing when I was a MP, and I am hearing the same story now I am the PM. You will not develop it yourself, and you will not allow us to develop it for you. You will remain poor, and you will also cause us to remain poor". This was frustration from a very powerful man, who could not break the barrier of mistrust Nepalis have for any Indian initiated development of our most coveted resource.

We need to let go of the mistrust with India and play with them on pragmatic level. While we must maintain control of the national priorities, we must work with Indian and other foreign investors on mutually beneficial grounds. We cannot sit on the hydro-potential for ever. Nepal should also be very clear on what it wants. There will be cost of development. There will be loss of some control when you do a big trade. There will also be social perversions and environmental degradations that will accompany hydro development. We must assess them carefully and accept some costs.

(Ambika P. Adhikari)

I agree that we have to have some sort of understanding with Indians for the development of hydropower in a big scale. But are they interested? I am asking this question because despite Parliament's ratification of Mahakali treaty nothing has happened. There is a school of thought in Nepal which says that Indians are interested in river treaties, more for water than power. They can have power from other sources, but their problem in the foreseeable future is the availability of drinking water.

(Keshav Upadhyay)

As a political economist I see the need to develop Nepal's water resources speedily. There is no point sitting over it and let India develop all the water resources and have the claim of the first use. But that should not mean pawning all our water resources for perpetuity. We will learn by doing. We had a very bad experience with Koshi, Gandak and now Mahakali. Why is Mahakali Nepali side of the *bandh* [dam] so high that water flows to Nepal only during rainy season? Why did we renew the Sharada agreement without amendment when it expired? Why do we always get hoodwinked? Are we able now to negotiate with more technical knowledge?

Will bringing in the Indian private sector make the Indian investment to Nepal's need more responsive? Our experience with the Indian State has not been happy. How far the Indian State is willing to change? Once these issues are sorted out, technical questions, environmental issue etc. can be solved easily. But given Nepal's terrain, investment capacity, and difficulty in network expansion due to terrain, perhaps smaller projects should be supported actively for rural consumption in the Hills, while a few larger projects taken up both for export and Nepal's industrialization and transport development.

(Meena Acharya)

Most of us turn blind eye to the fact that interest of India on Nepal is not on getting electric power but on securing water supplies be in the name of high dams or the lower riparian state. One should read the mind of South Block not whether the Indian States facing shortage of power supplies.

(Dileep Adhikary)

Forget India. If they want Nepali hydropower they will come on their own. And the subject has now become so sensitive that no politician wants to be seen selling hydropower to India because then he would be charged of selling the sovereignty.

(Keshav Upadhyay)

Regional FDI might replace FDI from far …

Hydropower development in Nepal has long been held as a panacea for Nepal's economic development. The government and foreign-aided hydropower development have not been that successful, both due to large per unit cost (construction inefficiencies, graft), and problems of maintenance. Since 1992, the private sector development of the hydropower was seen as the best approach to utilize Nepal's most important economic potential while utilizing the private sector efficiency. There lingers a vast controversy on the modalities of these investments. Although the previous few private power development projects were carried out by the US, Australian, Chinese, and a few other companies, the most successful ventures have been the ones organized by the Nepali investors.

The most recent private hydropower development projects are almost all proposed by Indian or Indian-Nepali joint investors. This is an interesting change and merits a careful review. The Indian companies are perhaps, best suited to operate in Nepal due to their proximity, cultural and economic understanding of the Nepali situation, and relatively low cost of their professional and other costs. More importantly they are in the best position to negotiate Indian market for Nepal generated power. However, Many Nepalis are long concerned about the possible compromise of national security, and monopsony by the Indian state in the development of Nepal's hydropower. Also, Nepal wishes to diversify its investor's list, and wishes to attract non-Indian investors in the power sector to obtain foreign technology and also to counter the enormous Indian influence in Nepal.

(Ambika P. Adhikari)

I found the differentiation between the Indian State and Indian private-sector FDI very revealing indeed. Same differentiation can be made between the Nepali State and Nepali private investors/NRNs. I believe paying attention to such subtleties might open new doors in future.

(Mallika Shakya)

(b) WHAT IS THE MARKET?

Nepal's own internal demand is skyrocketing …

My estimate indicates a figure of nine billion rupees that must be invested annually to meet the rising demand of 60mw per year.

(Keshav Upadhyay)

The discussions on February 18 and 19 mainly focused on power sector in Nepal, especially Nepal's bitter experiences with FDI in Khimti and Bhotekoshi projects (and) the severe crunch of power shortage in the country.

(Vijaya Sharma)

The private sector power development did face hurdles. The BhoteKoshi power purchase agreement generated much controversy inviting intervention from the US government and law suits from the private developer.

On the other hand, some local Nepali invested smaller projects have become successful and profitable. They catered to the available demand, utilized local man-power and professional expertise, and were much better grounded in the local reality.

The many black -outs, load- shedding and lack of power for industries are proving that there is enough domestic demand for power in Nepal. Further, with the rise of income that is anticipated in the post-conflict

Nepal, the emerging Nepali economy should be able to absorb power from several small and medium size projects.

(Ambika P. Adhikari)

A discussion whether India is interested or not on Nepali hydropower should be concluded only after we have tried the Indian private sector. Nepal is probably not capable enough (yet) to tackle the Indian businessmen, but there are many brokers in the international market that can do this job for fees. All this only emphasizes the need for a better business enabling environment and investment climate, which is the State's responsibility. I very much agree with AmbikaJi about increasing local demand for power. This may even make Component C redundant. To encourage local absorption of hydropower, it is imperative that the hydro strategy doesn't stand in isolation but is closely linked with SME development strategy. The ongoing *safa tempo* [clean autos] strike in Kathmandu to protest the power cut reminds us of the direct connection here.

(Mallika Shakya)

India remains a large market and we should tap alternative avenues if the government channels are not working

In my opinion, a major problem faced by the middle and large sized foreign developed projects is the difficulties in accessing the Indian market. Although some experts have talked about it, no one has seriously explored the national consumption potential, and increasing the domestic demands for power in the interim.

(Ambika P. Adhikari)

I do not know what the answer is for our own internal housekeeping, for example, for or against FDI and/or expediting the regulatory process. But, the rising economic super power –India—is not certainly waiting around for Nepal to be the source of its energy needs. Any unnecessary regulatory mechanism to slowdown FDI in the hydro sector will hurt us from becoming a player in the emerging regional energy market. I am sure that the Indian economy's double digit growth and its rising energy consumption need have not gone unnoticed among the policy makers in Nepal. Pakistan is another potential market, and between the two of them, the South Asian region could be a vibrant market for energy exports and imports.

India has already begun to look into its insatiable energy need from a larger regional perspective, and Nepal may or may not factor into this equation. The choice is ours to make. From this perspective, the state's role is vital in developing the necessary groundwork to make us competitive in this vast energy market. To that end, making government actively involved in the FDI regulation may prove to be counter productive. India has increased its involvement in Bhutan's hydro sector, and is looking to import gas and electricity from Bangladesh and Myanmar. India is also looking to invest in a coal plant in Sri Lanka.

(Alok Bohara)

I am still not convinced why do we fully exclude the possibility that the Indian private sector might be interested after all? If there is a market demand, what stops them from exploring new economic opportunities in Nepal especially when they have a competitive advantage over others on knowledge and information? For example, Bangladesh has been totally unsuccessful in selling its gas to India, but Tata is very much making its entrance there. Are we exploring that possibility at all?

These same issues might be very much relevant for various other industrial sectors, e.g., roads, telecom, IT, tourism, etc.

(Mallika Shakya)

South Asian and Central Asian market potentials are also there …

On the western front, Pakistan, Afghanistan, Tajikistan, and Kyrgyz Republic are assessing the prospect of exporting about 1000 MW of hydropower from Central Asia to South Asia with the possibility of importing gas from Iran and Turkmenistan. With a population of 1.5 billion people, this region (including SAARC) could be one of the largest markets for energy consumption. Thus, the regional trade in energy is not a distant hypothetical fantasy anymore. Within a decade or so, we may be seeing regional grid sharing and power trading all across the sub-continent.

Can Nepal afford not to join this regional energy market? What export policy does Nepal need to facilitate such an option? What can we learn from Bhutan? Should we be focusing on Indian private ventures for our hydro developments? What could be an efficient energy trading model?

(Alok Bohara)

(c) <u>WHAT ARE THE KEY TRANSACTIONAL ISSUES?</u>

PPA and environmental assessment remain thorny issues …

Private power producers need to pay for insurance, legal costs and interest during construction. We always compare these costs with NEA developed projects like Kali Gandaki and now Middle Marsyangdi where there are neither elements of interest factored nor any financial considerations on account of delay factored in. If we take both into consideration many studies have shown that Kali Gandaki is perhaps more expensive to the economy than the IPPs. The fact that Chilime, the NEA promoted company has a rate that is close to the IPP rates perhaps reflects on the fact that if we have to assume that there is cost to money and money is not free and there is a concept called time value of money and delays do not amount to cost, then the rates paid to IPP are close to the real prices. If we continue to harp expensive power by comparing oranges with apples then we will land up writing many seminar papers, but Nepal will continue to reel in the dark. It is like complaining about foreign airlines that charge dollar fares that ferry Nepalis outside Nepal taking business away from our national flag carrier!

If NEA has bled on account of exchange losses by paying dollars rates to Bhotekoshi and Khimti, it would be interesting to see the balance sheet improve this year when the dollar rates have actually come down making the prices of Chilime and Bhotekoshi the same.

(Sujeev Shakya)

Could Merchant Power Stations without a legally binding power purchase agreement be built in Nepal? Would anybody invest in it? There was a small mention (in the meeting) about energy price of Chime. It is at par with Khimti and Bhotekoshi, even a little higher, though I am not quite sure about it. But Chilime people would hotly deny it. They would say that since NEA owns 51% of the equity in Chilime, NEA does get a very good dividend, and so if you take that into account the effective rate, it would be much lower than Khimti or Bhotekoshi’s.

(Keshav Upadhyay)

Also to respond to SujeevJi’s assertion about shortening environmental assessment procedure, I beg to disagree. Nepal’s geology is very fragile, its bio-diversity highly vulnerable, and the rural population powerless to block large developments. In fact, in the equation of power development, the local communities lose the most as the power is transmitted to urban areas and possibly to India, leaving the local communities to bear the brunt of the environmental damages, while most of the time not even getting any power. Even when power may be available, they cannot afford the price.

During the late nineties, I was involved in the socio-environmental impact management of the Bhotekoshi power project during its developmental phase. I remember how the locals lost precious amenities, how their houses were creaked due to blasts during construction, and how they were displaced from the places of their adobe. The only gains were that some villagers got the menial jobs temporarily. I strongly believe that socioeconomic and bio-physical impacts of the large hydropower projects should be rigorously prepared, actively mitigated, and regularly monitored. State's regulatory roles are critical in this phase.

(Ambika P. Adhikari)

Calculating time, opportunity costs …

In the power sector we need more radical reforms to look at the scrapping the system of PPAs and survey licenses and at shortening the Environmental Impact Assessment timeline. There is a demand for power in Nepal and India and there are projects that can be developed; so, leave the rest to the market. People are sitting on survey licenses (bestowed upon by political masters) for years. Like sitting on plots of land and not building houses they are trying to cash on the premium. Scrap the licenses, (and) let (those) merchants (build) power plants who can manage risks (that) come up with power; they will find the market themselves.

(Sujeev Shakya)

I understand very well that alternative investment opportunities are high in advanced economies which skyrocket their alternative costs as well as make LDC State guarantees less attractive. One solution might be to accept this at the face value and go with the high costs factored in. But LDCs in the increasingly globalized world do have a better option, which is to seek local and regional funds. Often, these local/regional funds are the victims of the same evil. SujeevJi rightly pointed out that Nepalis sit in a plot of land for years without building on it. Does this not, at least in principle, give a local visionary entrepreneur an opportunity to develop a local/regional hydro fund?

I am not too sure that Nepal's current hydro loss is coming from the subsidization-vs-capitalization dilemma. I think a larger factor might be the problem that the one component was never sufficiently dissected and differentiated from the other. We cannot ignore the importance of mini-calculations and comparative bargains from within the country and within the region.

(Mallika Shakya)

Risk management related issues

As far as commercial banks are concerned, hydropower financing represents a small portion of their total risk assets and they are still testing the waters. Mostly the involvement in a project is below 50 per cent of their Single Obligor Limit (SOL). To raise money for 5 MW projects, more than five commercial banks will be involved. The following factors are responsible for the slow take off of hydropower financing.

1. long tenure of loans
2. longer construction period requiring interest capitalization
3. lack of understanding on the part of the lenders on technical aspects of projects
4. absence of credible agency for verification of various costs (civil as well as electromechanical) and suitability of the equipment associated with the project
5. absence of proper dissemination of information on credit enhancement such as insurance
6. political situation of the country. Contradictory messages from the responsible persons in political parties.
7. over eagerness of promoters in reducing the cost of the project resulting in wrong choice of contractors/equipment suppliers.
8. financial health of the only buyer of the product, NEA
9. non-clarity on the price escalation factor on PPA (for 100kw to 2000kw projects) after 2060/61, for power projects which have already signed PPAs with NEA (6 percent per annum till then)
10. case to case decision by NEA on the imposition of penalty if the commercial operation is not started as per the PPA
11. lack of close cooperation between the lenders and the borrowers resulting in various amendments in the agreements signed by borrowers (with civil contractors/electromechanical component suppliers etc)

12. lack of clear distinction between promoters and contractors/suppliers.

Some of the issues can be taken care of by professional bodies (Association of IPPs and others) or bilaterally between borrowers and lenders. However, some of the constraints mentioned above need the involvement of agencies/individuals in a structured way. Independent institutions need to bridge the gap between the prospective lenders and borrowers. Financing in hydropower is still at a nascent stage and confidence-building measures by these institutions will pave the way for greater involvement of the commercial banks in this sector.

In hydropower project financing, banks will prefer:

- debt: equity ratio between 60:40 to 80:20
- timely infusion of equity by the promoters
- construction period of not over two years
- grade period of 3-6 months
- total loan period between 7-9 years (including construction and grade period)
- detailed background checks on the suppliers, especially from emerging markets, and contractors
- financial guarantees from sponsors to take care of cost escalations, if any, if the project contracts are not close ended
- updated and on demand information on the project
- clear separation of interests of the sponsors and contractors/suppliers (no conflict of interest)
-

(Nirmal Dahal, Manager, Credit Risk, Laxmi Bank Ltd)
(Published in New Business Age, January 2007)

Variation is a trap when trust is none

'Variation' is one world media has discussed most recurrently in the context of large construction projects, which has to do with the deviation in production volume, cost and schedule that significantly affect projects. Although variation could mean both rise and fall in costs, in Nepal's context, variation has been synonymous with rise in costs and project delay. Kaligandaki and Mid-Marsyangdi are two recent examples.

Deviations are bound to occur throughout the hydropower project cycles because the geological details start to manifest only after the tunnel is dug.

Let's take the example of Chilime, which started out with estimations that the tunnel will penetrate 1930m of good rock, 1930m of regular rock and 566m of difficult rock. It turned out it was faced with over 2700m of very difficult rock, increasing the consumption of iron 300% more than originally estimated.

The legal contract often spells out provisions for variations and larger projects follow the guidelines provided by the International Federation of Consulting Engineers (FIDIC). FIDIC engineers have a profound role in amendment of designs and estimation of costs arising from variations. Engineers' lack of credibility, experience, and efficiency will lead to claims and counterclaims jeopardizing the life of the project itself.

The FIDIC engineers in multinational investments are selected through international competition, e.g., MKI-USA in Kaligandaki. KG's average production cost was estimated to be USD 2530/kw and fuel production cost US cents 4.52/unit. But bilateral donor projects require that FIDIC engineers are selected from within donor nationality contestants: the German Fisher JV in Mid-Marsyangdi project is one example. MM's average production cost was USD 5450/kw and fuel production cost US cents 12.7/unit. Chilime designated the project head to function as the civil and hydro-mechanical engineer. Chilime's average production cost was USD 1583/kw and fuel production costs US cents 2.6/unit. Puwakhola in Ilam designated the Engineering Directorate within NEA for this purpose. Its average production cost was USD 2865/kw and fuel production cost US cents 4.63/unit. Modi designated a team of donor/local consultant agencies and NEA engineers. Modi's average production cost was USD 2074/kw and fuel production cost US cents 4.25/unit.

Variation is a normal process in construction projects. It is important that donor-granted projects also select FIDIC engineers through international competition process to avoid negative effects of variation. Since research and analysis are crucial for any discussion on variation-related issues, it is important that the State makes provisions to involve engineering students in study and analysis of these issues. NEA itself can form a division to properly investigate, research and evaluate the impacts of variation in the major hydro projects and institutionalize/disseminate the lessons learnt. It is both a challenge and opportunity for engineers to demonstrate that projects can be accomplished with minimum disturbances in costs and schedules despite serious variation issues.

(Lilanath Bhattarai, Manager, NEA & Chief, Chilime Hydropower)
(Published in Himal Feb-Mar 2007)
(Unofficial translation: Mallika Shakya)

(d) WHAT ARE THE POSSIBLE MODALITIES AND WHAT IS THE ROLE OF THE STATE?

Should hydropower be a commercial commodity or essential infrastructure?

The problem with hydropower is how you treat power in the economic schema. Do you take it as an essential part of infrastructure, or is it a commodity like say a pair of shoes? There are two sides, both equally important. First one is of course the need for investment, where does the money come from? If you give a handsome return to the investors, investment will surely come. But then the price of energy will go soaring high. Can you allow that? What would be the impact in the macroeconomic sphere if you let that happen? It is here that I think there is a need of serious intervention by the government. If you are clear about it, color of the cat is not important.

(Keshav Upadhyay)

Is power not a single unit but multiple and eclectic? Its commercial components might include core components of power generation, but its infrastructure components surely include the public goods of roads and transmission lines. But in today's financial sophistication, it should well be possible to differentiate the treatment of these two components so that we avoid the dilemma of subsidization versus capitalization.

To take one example, from Bangladesh, the power finance facility, first, set up a public fund (through govt., multilateral and bilateral donors). They then dissected this into two sub-components, each managed by different entities. The government managed the first subcomponent: First, it developed an eclectic (as opposed to 'thick') infrastructure plan based on social-cost-benefit-analysis (as opposed to financial CBA). Second, the plan mobilized the donor support to award contracts to private bidders on a competitive basis. Since the fund was based on the local currency, bidders were either local companies or were sufficiently locally grounded. The second subcomponent was a purely commercial credit which was managed by a commercial financial institution for commercial remunerations on commercial principles.

(Mallika Shakya)

Unbundling power generation from distribution so risks become more manageable and more bidders can participate …

The transmission lines have to get to a special purpose vehicle owned by the state and let everybody use it like they can use the road by paying tolls. Let distribution be managed by municipalities who know the customer better and cut debtors. Let private sector be just allowed to build generation plants. If we take the potential of 40,000 MW to sell at 5 cents a unit based on current estimates, it can fetch $ 150 billion plus revenues. We need to re-engineer our thinking.

(Sujeev Shakya)

AmbikaJi suggested that local/regional investors better adapt to demands at lower prices but cannot influence the Indian giant, while larger FDI are worse in former and better in latter. But need this impose a policy trade off for Nepal? Can we not have the good of both the worlds? Let's develop a hypothetical model where a hydropower project is divided into three clear components: A. infrastructure and connectivity; B. core power generation; C. international/regional mediation for market. Components A and C are clearly public goods while B is private.

An efficient and competitive PPP (this could be a restructured NEA or a different institution) can manage component A (with some donor funding). Component B should be private -- the choice between local, regional and international investment -- will be decided by pure competition (bidding prices + environmental/social CBA). Component C can be headed by the PPP but subcontracted to a top-notch private business strategy MNC that can bring business leaders from India on board. Whether or not local capital is better than FDI should be left to the market on purely commercial products. The State should have a role on public goods. This will not only increase the number of private bidders but also will bring down the total costs substantially.

(Mallika Shakya)

My argument for unbundling of NEA is to segregate transmission (which would be held by the public institution) from core power generation (carried out by independent power producers from private sectors, be it local or foreign) and distribution (again independent location specific that would be catering to user committees or power consumption complexes).

The transmission company charges a rate which either would have to be absorbed by the producer or distributor, depending upon the negotiation between the producer and distributor.

When we talk about big (MW wise) and cheap (power cost wise) projects we have the habit of crossing the border to dispose off the energy thus produced, forgetting the fact that Nepal itself can absorb 10000 MW of power immediately if it is linked to preservation of the forests and thereby ecology as well as curtailment of gasoline using vehicles that pollute the cities and the highways. There are decent ways of promoting its applicability at the real life situation. Experts with ideas are there in Department of Wild Life and Nature Conservation, and National Trust for Nature Conservation

Time has also come to think of technology to disintegrate water into oxygen and hydrogen for use of the former as a life saver and the latter as energy alternative.

(Dileep Adhikary)

I generally concur with DileepJi's argument. Unbundling of generation and distribution seems to be standard panacea, first used in England, and then copied by California in mid 90s. (Of course, California energy crisis was precipitated by it, but it had more to do with financial market failure rather than unbundling itself. Plus, now we can learn lesson from their mistakes to avoid such crisis.)

Two points: (1) Distribution sector should still be retained by public sector because of inherent increasing return to scale in that sector. It is standard prescription in this field. (2) As for generation, slowly, I think the property rights for electricity generation sites should be transferred to local government. I am beginning to believe that political situation will evolve so that these districts will soon hire their own police force and judiciary. The tragedy of Arun, Melamchi etc shows that local population could be instigated by any two-bit NGO in KTM to oppose these projects. Giving property rights to these small administrative districts will solve these local non co-operation issues, and increase efficiencies.

(Biswo Poudel)

Other modalities and issues …

Before IPP came into the picture, all the dealings of banks in this sector were with the state-owned NEA and only a few banks were given access to it. Now the scenario has changed. Most major banks are involved in financing the hydro sector in one way or the other. Some have financed the privatization of the state's share in hydropower companies, some have financed the purchase of the shares of foreign investors in IPPs by domestic companies and some have provided direct financing to IPPs. In the first two types of transactions, the source of debt repayment was the cash flow of companies already in operation. In the last type of finance where banks have directly financed the IPPs, the element of risk is quite high as they will be involved from the initial stage of project construction.

Financiers and Project Financing…

Financing of hydropower involves long-term commitments from commercial banks. However, traditionally banks have preferred financing with short term commitments. Furthermore, infrastructure projects like hydropower require longer construction periods. Due to the nature of the finished product, there has to be a confirmed buyer for the electricity produced (unlike the other traditional financing of merchandising nature in which products don't require particular long term contracts for the sale of goods produced).

The development of a hydropower project requires the involvement of various parties, developers, consultants, suppliers, contractors, operators, buyers, regulators, local bodies, etc. The duties and responsibilities of the parties involved are established through contracts. In this type of financing, the contract is the king. A lender has to go through all these contracts in order to understand the project.

As in other types of financing, the major risk for a bank is the credit risk (default risk) – the borrower may not service and repay the loan as per the commitment. Mere reliance on a contract will not be sufficient in addressing this risk. Hence banks request for various credit enhancements to mitigate it. Some common credit enhancement devices considered by commercial banks are:

- direct guarantees (sponsors, third party or other participants)
- indirect guarantees (take or pay/take and pay)
- letter of credit
- surety obligations (bid bond, performance bond, payment bonds)
- insurance (including advance loss of profit/loss of profit)

- unrelated fixed assets collateral

Due to the nascent stage of the financial sector in Nepal, it will take some time for banks to lend on pure project financing terms where the lending is secured purely by the underlying cash flow of projects and contracts. So the development will be a gradual process. First the market will have to be matured to a partial project financing mode where credit enhancement will be limited (requirement of personal guarantee of the promoters only till the time the project comes into operation and requirement for unrelated fixed assets).

(Nirmal Dahal, Manager, Credit Risks, Laxmi Bank Ltd.,)
(Published in New Business Age, January 2007)

(e) INVESTMENT CLIMENT, ENVIRONMENTAL CONCERNS, POLITICIZATION AND RENT-SEEKING

De-license hydro …

In the power sector we need more radical reforms to look at the scrapping the system of PPAs and survey licenses and at shortening the Environmental Impact Assessment timeline. There is a demand for power in Nepal and India and there are projects that can be developed; so, leave the rest to the market. People are sitting on survey licenses (bestowed upon by political masters) for years. Like sitting on plots of land and not building houses they are trying to cash on the premium. Scrap the licenses, (and) let (those) merchants (build) power plants who can manage risks (that) come up with power; they will find the market themselves.

If we have no problem in allowing fish which is a by-product of water to be traded freely, why do we have problems in ensuring private trading of electricity which is a by-product of water?

(Sujeev Shakya)

NEA or no NEA? First thing that has to be done by the Government is to establish a regulator who can balance the interests of both sides: investor and consumer. It is very good for the government too, because it takes on the responsibility of often unpopular pricing decisions which have to be taken for the sake of the sector as a whole.

Do a massive restructuring of NEA. Take away distribution from it, initially. Give it to private companies or local bodies. We started privatization in electricity from the wrong end. The reason obviously is that MNCs are not interested in distribution, it is a messy business. Generation is rather clean.

(Keshav Upadhyay)

Most of us give blind eye to the fact that interest of India on Nepal is not on getting electric power but on securing water supplies be in the name of high dams or the lower riparian state. One should read the mind of South Block not whether the Indian States facing shortage of power supplies. With this clarity engage multi-lateral agencies like ADB to be the go-between even for the promotion of Private HE with India as a market.

Government as investor in NEA has serious limitations to provide funds for NEA to make investments and presently NEA has serious limitations of its own income to generate surplus for investments.

The current banking regulation in Nepal is to not help promote even medium size (60-100mw) projects. … The current practices for micro/small projects are based on milking NEA, not on the basis of competitiveness. … But in developing hydroelectricity to the desired/competitive level, unbundling of NEA is a critical requirement.

(Dileep Adhikary)

We agree that hydro-investment has to come from the private sector and the public sector should facilitate it. Here do we have a good model for public-private-partnership that would satisfy the demands of investment, financial efficiency and knowledge transfer? The need to rid NEA of political appointments and outdated knowledge is well established. Can this be achieved in practice? And is the problem all political? What technical capacity is NEA lacking which makes its performance so dismal? Maybe it is NEA that has to be privatized, especially in facilitating smaller projects more efficiently, as DileepJi has pointed out.

The role of ADB and other multilaterals in promoting Nepali hydropower in the Indian market: Has ADB done this for any other countries? Some of the examples from East Asia, if this is the basis for our hope on ADB, might actually be less relevant for South Asia simply on the grounds that East Asia enjoys far better regionalism than South Asia and hence persuading powerful neighbors might be an easier task there. How about multinational business strategy companies who might specialize precisely on hydro issues?

FDI is directly connected with technology transfer. If we missed the technology lessons on how to build it locally next time -- they call it 'the Chinese lesson' -- we wasted our opportunity in real terms. This is where the State has a role, regardless of whether it is Red or Blue. This is where NEA should have a role; and if it does not, then a new institution should be developed to take this vital role.

(Mallika Shakya)

Politicians' rent-seeking …

Should not the political parties cease to make it an issue of party politics? What do we do with the demands like that India should pay for the Nepal's share of water it uses, until Nepal can use its entire share? The water is flowing any way. To me it seems Nepal needs to ensure only that it can use its share when it wants.

(Meena Acharya)

Our 'mindset' …

This sector failed to grow. The main factor is the mind-set. We neither do on our own nor allow the others to contribute in this sector. In regard to external investor in this sector, we have a mind-set that we will be cheated if at all we make a deal. Mahakali Project is its glaring example. Despite the fact that the Project was framed on the basis of equal participation both in investment and returns, we did not allow it to materialize so far. Even in project such as Arun III, we did not go forward though it is most feasible project. If at all we have shown interest in certain projects such as in Marsyangdi and a few others, it is just because it served the vested interests of certain groups.

Therefore, the main problem is educating ourselves. We have to come out of the well and make meaningful dialogue maybe with our neighbors or agencies outside the region for making best utilization of this scarce resource. But for all this, the mind-set has to be changed and vision has to be created that Nepal needs to be made an affluent country, rather than a country moving with begging bowl. If we are clear about it, development of hydropower to a desirable level does not seem to be a problem.

(Hari Bansh Jha)

Educate the public …

Educate the public that hydropower does not come cheap; massive investments are required upfront to construct the power stations, transmission lines, etc. The only attraction it has for us is that we do not have to be dependent on import of other materials for our energy needs. Stress the security angle that it provides, and say repeatedly that if we tighten the belt now we will be free of the worries of Nakabandi, like the one we had to face in 2046.

(Keshav Upadhyay)

3. 'SMALL' PILLAR: SMALL AND MEDIUM ENTERPRISES (MSME)

A good business enabling environment more important for the MSMEs than for larger firms. The State has a crucial role in improvement not only in regulatory procedures and development of backbone services, but also in quality enhancement and overall equity of services and opportunities …

What a state is supposed to do is to improve the business environment; it will not be able to do it if it is politically weak on the one hand and administratively confused on the other. My contention has been that it should be policy making/implementation role for the ministry, regulatory role for the government department, non-commercial services for the public institution/enterprise and commercial activities for the private. Presently, you will find ministry involved at the project level as well.

Activation, innovation and competition should be left to the private sector, and the State should provide suitable legal and institutional frameworks to create environment for the private sector activation, innovation and competition. The state should cooperate from behind, not try to lead from the front. The thrust required is on the front of infrastructure, and on the arena of marketing and financial dynamics beyond the traditional buy and sell and the traditional production credits. Missing are the services linked to outreaching the market which would demand a specific highway specific to product or services, and missing is the financing (that embodies banking and financing beyond what is practiced or served currently in Nepal).

Integration is the key in the upcoming of the private sector which links it from source to production (product or service) to market. Assuming that macro policy (of openness and competition) is here to stay, and that objectively we have to attain the economic growth of sustainable magnitude through the expansion of the private sector activities, then what needs to be pitched obviously is the appropriate legal and institutional frameworks. Unless the government understands how a business happens and that too at competitive terms the private sector will be too weak to raise Nepal. That should be the starting point.

(Dileep Adhikary)

Dileep AdhikaryJi rightly emphasizes the improvement of legal and institutional framework for PSD. Although there has been a large successful sectoral growth of private sector institutions in education, health, and finance in Nepal, it is important to remember that free markets only cater to people who can vote with money. The result is a gross disparity in access to quality services between Kathmandu and outside, and between the well off and worse off even within Kathmandu. While the growth of private activity in these sectors poses no direct problem, the increasing inequality that results from it does.

(Mukti Upadhyay)

DileepJi has used the terms 'business environment' and 'legal and institutional frameworks,' but some of the State's roles require hands-on actions rather than passive preservation of environment. Physical infrastructure and backbone services alone require active engagement from all sides.

I agree that the State must not try to lead but facilitate 'activation, innovation and competition' from the private sector. Facilitation of this innovation and competition will require establishment and nurturing of a whole tier of institutions that actively promote and enable good practices from the private sector. For example, brand-building or niche marketing is an area where small countries like Switzerland and Nepal have competitive advantage in products/services like carpets, tourism and handicraft. Such sectors will require massive efforts on physical infrastructure, backbone services and image-building. The Indian government spent four million dollars to develop 'India Everywhere' brand to entice the foreign investors and convince them of its financial credibility, which was then extended to 'Incredible India' brand for its tourism market, and now a whole range of Indian products like IT, medical services, etc. capitalize on it. One might say national brand is a big brand; private sector firms can go ahead and develop smaller product brands for their individual products. But, the private sector will need to have the right training/technological institutions to achieve the quality, then certification agencies and harmonization procedures to gain credibility, then promotion agencies to reach out to consumers, a sound legal framework for incentive to innovate.

Bhola ChaliseJi pointed out in his comments, that of a bureaucratic duty drawback for exporters which is too time-consuming to be useful. The only sector which could convert this to a more user-friendly ‘bank-guarantee-system’ was the garment industry. This shows that name of the game is public-private-partnership or meaningful dialogue between the two. Both of these require very specific knowledge, skills and experience, and of course the right mindset. But this is very much the precursor to PSD.

(Mallika Shakya)

And corruption remains a contentious issue …

While speaking of the private sector development and the state’s role, the issue of transparency becomes a natural topic of focus. The newly passed Competitive Bill (February 2007) seems very comprehensive in its scope covering numerous angles such as, tied selling, bid rigging, cartel, collective price fixing, market restrictions, dial-system, market segregation, undue business influences, syndicate and exclusive dealing. The government must be congratulated for the announcement. But, it looks like a daunting task, and it will not be cheap. It will involve a sizable workforce to detect violations. The legal cost of prosecution will also have to be figured into the total enforcement cost. The stipulated fines of Rs 10K, Rs. 25K, Rs. 100K and even Rs. 300K don’t seem severe enough, and are most likely to be internalized as a part of cost of doing business and will be passed on to the consumers in the form of higher price. Furthermore, these regulations are also likely to increase the rent seeking behavior of the government employees and increase the opportunity for corruption. The Competitive Bill needs to be equally matched by the other corruption control measures and transparency measures. A city like Bangalore, for example, reduced its low level rampant corruption by 30-40 % within a year or two by simply creating barriers between the “public” and “the clerks”. For example, Instead of making the public stand in line to get government services (e.g., paying bills, registration renewal), the government instituted the envelope drop-in system. This type of e-governance system diminishes the contacts between the public and “the clerk-babus” and thus reduces the opportunity for bribery.

Advanced market economy like the US is also not immune to malpractices in government contract deals. Consider the following data: Of the $380 billion government contract dollars in 2005, 20-30%, were rewarded without any genuine competition. But, unlike in a country like Nepal, there are civilian oversights of these activities, which include hearings at the congressional level. In 2005 alone, the Public Corruption Program convicted 759 cases out of 890 indictments. It is quite routine event to see the congressmen convicted and put in jail. Even the all-mighty Enron was brought down to its knee. Over 1000 government employees were convicted by the FBI just in the last one or two years. Thus, it would be useful to find out how the procurement practices are carried out at the government level in Nepal. How transparent are these bidding practices? Do we have any civilian oversight? Do we have any whistleblower law in Nepal? It would also be interesting to find out about the internal bidding mechanism of the government tender.

(Alok Bohara)

A ‘cultural’ dimension is either ignored or misunderstood in the PSD discourse even though Nepal’s international competitive advantage draws profoundly on it.

Mallika Shakya has written a lucid essay on the issues relevant for drafting a workable strategy of Private Sector Development (PSD) in a transitional Nepal. She has pointed her finger at the interventions required to address the "ethnic and gender concerns without self destructive compromises on market rigor". Since the redress of ethnic and gender concerns would definitely distort the market in some ways it is here that I am not comfortable with her prognosis though I would very much like to agree entirely with her because the concerns are genuine. It is not that there is any argument with the politico-economic agenda of inclusive democracy; it is the question of strategy which is a matter of debate. Though the country’s politics has visibly veered towards far left, there is no point in developing a strategy of PSD for an extreme left regime that would give no role to the private sector. A realistic PSD strategy has to dovetail into the socio-economic agenda of the liberal left; otherwise the whole exercise could turn into idle play of words. Small pillars of the economy like micro credit and cooperative initiatives, I am sure, would fit seamlessly into the new scheme of things, so the stress would naturally go in that direction. But, as the author has rightly stated, there are some sectors where inducing bigger investments would require a totally different approach.

(Keshav Upadhyay)

While I totally agree with being cautious and preventing gender/ethnic inclusion from distorting the market, yet cultural capital can be a real potential for Nepal where branding the cultural/geographic products (handicraft, tourism and specialty goods like tea, coffee and carpets) for global niche markets is one of the most promising avenues for international competitiveness. At the moment, Nepal does this task haphazardly and is not very successful at it. One example comes to mind is that of a Bahun and a State bureaucrat trying to sell the ancient Sherpa heritage to elite culture connoisseurs without knowing one Sherpa word. The same Bahun can do it much better only if he is prepared to invest a couple of years learning about the Sherpa culture/history and another couple of years understanding the international clientele he is trying to serve.

Let me state another small example. One of the most important of Nepal's export is traditional handicraft. Here, by being ethnically insensitive, the State is losing out a lot. Over 85 per cent of the members of the Handicraft Association of Nepal (HAN) are Newar traditional artisans. But, their programs for developing international certification, copyrights, and marketing are extremely haphazard, because the State does not appropriately recognize ethnic skills. The State definition of expertise ends at formal mainstream school education. As a result, a superb master of statue-making fails to get government accreditation as a trainer/certifier if he/she does not have a diploma, although that is irrelevant for the area of expertise. What this has meant then is that a secretive, uncoded, monopolized, and hence rudimentary system of accreditation tightly controls the statue-making enterprise, which is a total loss for both the artisans and the State. The government can solve such a problem by offering more ethnically nuanced accreditation/training system, which on the one hand, will lead to formalization and hence wider access to ethnic skills, and on the other hand, will lead to better recognition to ethnic identities in society.

India has developed very sophisticated classical art academies which give credit to the masters of those arts, while giving a wide range of people access to those arts. Classical arts have helped tremendously in building an international brand of India and in marketing of not only specialty goods such as tea and herbs but also heavy products such as Indian airlines and IT services. Cultural capital is very much part of the India brand. I also believe that exploiting the potentials of cultural capital is healthier than a myopic focus on distribution at the expense of economic growth. While societies will continue to negotiate the shares of the pie, it is also important that each of the shares also contribute creatively towards making the pie bigger.

(Mallika Shakya)

Other MSME issues: micro-credit, community forestry and remittance mobilization have been overshadowed by 'bigger' issues of FDI and hydropower

First of all, one must appreciate the silent revolution on grass roots economic front that is going on in Nepal since the days of small farmer development program. Then there came Community Forestry. These innovations must be accredited to the government initiative. Right from the 1990s people have sprang up themselves which saw the mushrooming of self-serving community-based organizations (CBOs) which are still growing on with their saving and credit schemes.

In recent months, I am having several sessions with Dr. Harihar Dev Pant, Chairperson, NIRDHAN, in promoting One Product One Village (OPOV) in Bara-Parsa terai sections. As Nirdhan is contributing to micro-credit to poor lot in ten districts including these two, the need for graduating the micro-credit takers to micro-enterprise is the idea behind the concept of OPOV. Nirdhan will promote three micro enterprise centers with a plan I should be facilitating in terms of center identification, market linked product identification and entrepreneurs identification.

(Dileep Adhikary)

Another interesting development in Nepal has been the inflow of remittances. It is widely believed that, because of limited opportunities for investment in real capital, this has ended up either raising the price of real estate or giving some desired consumption boost among poor households. What institutional development will help to induce much of the remittance money toward growth of the rural economy? Is it feasible, for instance, to translate remittances into MFI loans?

(Mukti Upadhyay)

I very much agree with MuktiJi that the flow of remittance and flow of people might give us a unique window of opportunity in this regard. Does the State have a vision?

(Mallika Shakya)

4. PSD, HUMAN DEVELOPMENT AND SOCIAL ISSUES

Private sector's role in provision of educational services remains controversial …

The new political development has increasingly put the PSD under uncertainty. Though there is a realization that private sector is necessary, the likely inequality is taken as a political ploy for its rejection to backstage. Thus, there is also a need for strong analytical article showing enough evidence that the overall inequality does not negate the equality well at the higher level even for lower quintile groups ensuring better livelihood status. Further, the social protection measures compensate for and ensure the social service delivery reasonably at the higher level. The service delivery could even be better than that in socialistic economies. PSD also needs to highlight the public private partnerships in social service delivery so as to impress upon the general public that the profit motivated private sector will not leave the social service delivery behind. They are very much essential to be highlighted to stop the temptation to go for direct service delivery by the government machinery rather than through more market friendly measures.

Successful PSD assumes the existence of well developed regulatory system, and the role of the government's role in evolving such a rule based system needs to be highlighted to impress upon the populace that the government is not sitting silent and doing nothing before the market forces. It will give an impression that the government is fully aware of the concerns of disadvantaged communities and poorer section of the society and only thing is that such policies are to be market friendly. Let the government be smart enough in giving the message strongly that unleashing the private sector does not and will not lead to overlook the concerns of poorer section of the society.

The dislike for private schools and colleges in the name of more equal education (or equal opportunity to the education facilities) and in the face of limited public resource availability speaks these confusion and contradictions. Despite private schools sharing the obligation of the government in the drive for universal school education, in the absence of strong and effective regulatory mechanisms, private schools are also despised for brewing inequality in the society. How do we address this issue in the role of government in PSD?

(Bhuban B. Bajracharya)

Historically, education has been the best equalizer in many societies. Even the world capital of free market, America, provides free education up to the high school level for all of its citizens: rich, poor, whites, and non-whites. In Nepali case, despite much progress in the private education sector in the post-1990 democratic era, a dangerous segregation is taking place between the rich and the poor in the education sector. Wealthy families have access to high quality education offered by expensive private schools and colleges, whereas a vast majority of poor and disadvantaged students are stuck in the ailing public education sector.

The new government's attempt to chart a new educational strategy is a welcome sign. But, in the name of reform, imposing quotas, price control or nationalization will all be counter productive, and these overly restrictive regulations (especially banning or nationalization the private educational enterprise as proposed by the Maoists) are not the answer. The recent governmental ordinance, for example, requiring students to seek governmental permission from the Ministry of Education to go abroad for studies is an example of populist desperation rather than a sound policy prescription.

In addition to having a capital flight to India, such policies will also deteriorate in-school services. It will discourage innovations and Nepali ingenuity in the production of education, which has been a hallmark of the post-1990 democratic era. The point is that a healthy private sector can be constructive in helping the public sector, and in my recommendation, I am drawing upon my proposal which argues for a trust fund to strike that balance.

The proposed system of trust fund uses five percent tax from the total revenue generated by the private schools and colleges (i.e., all higher institutions). There are 1.5 million students in eighty-five hundreds private schools, and 70,000 students go to about 250 private colleges. Using a conservative amount of Rs 1,500 as a monthly charge, the five percent tax revenue will yield about Rs 1.413 billion for the trust fund. The second portion of the trust fund relies on a ten percent levy –about Rs 1 billion--

from the sin taxes on alcohol, tobacco, and casinos. [These are good faith guesstimates.]

Jointly, the five-plus-ten tax system can raise Rs 2.413 billion worth for the trust fund. Both sectors, being on the target list of the Maoists, should not mind contributing five and ten percent of their revenues respectively to this noble cause. In return, the government and the agitating student organizations should not be imposing unfair regulatory controls on them. The proposal then argues for allocating these monies to the graduates of the public schools for their higher-level education, including the vocational trainings.

(Alok Bohara)

It is a common knowledge that political parties have used schools and colleges as a training ground to groom young party activists. In addition, the Maoists have heavily interfered in the past years with the operations of even secondary schools and have argued for nationalization of primary and secondary schools.

Perhaps the most important criterion of measuring success of PSD in Nepal (at least in the near and mid-term) would be its impact on employment generation. For this, our educational system should be able to produce human resources that serve the need of the private sector. To better match supply with demand, I have argued for active involvement of private sector in developing and running a system of post-secondary vocational and training schools for producing mid-level technicians (read my views posted under “designated discussants’ comments”).

Participants with insights into the educational sector of Nepal could enlighten us with their valuable perspectives on the role of the government in promoting private sector participation in expanding schooling and educational system in Nepal.

(Vijaya Sharma)

I agree with Prof Bohara on the need for Education Trust Fund. There are certain disciplines such as medicine which have become simply expensive beyond the reach of even middle income families. We need to introduce various funding mechanisms to facilitate access of students from disadvantaged and low-income brackets to the education opportunities particularly higher education.

Private sector is coming up in many spheres of education including those in teachers' training and vocational and skill development. There again comes the role of government in PSD in education - that of ensuring standards and quality, once again a question of having well regulated system. With foreign employment expanding and its importance not waning in foreseeable future, vocational and technical education can be promoted for the skills required for such foreign employment.

With increasing number of educational institutions providing foreign degrees in the country (such as Cambridge A syllabus) and definitely they being in the private sector, there is a group strongly pledging to stop this practice to protect the national education system (SLC, national university degrees etc.). I think we can deliberate further in some of these interesting issues.

(Bhuban B. Bajracharya)

I agree with Prof. Bohara's proposal of a Fund and tapping the remittances. However, a big problem in education in Nepal is the archaic mentality of control rather than problem-solving mindset among our politicians, including the student unions. If you listen carefully to some of the advisors, Maoists and UML, they would allow private sector neither in education nor in health. The idea of a Fund is good, given the private sector is allowed to exist. Fund will be useful only if other aspects of education are also addressed simultaneously.

There is a big quality gap in the private education system in Nepal. The curricula and the textbooks of private sector schools cover histories and issues more relevant to India or developed countries rather than Nepal. The curricula glorify the countries to where these schooled are linked, rather than to Nepal's history and present day realities. All of the private school education is geared to sending students overseas, teaching their lifestyles and social patterns. Further, only a few schools go beyond rote learning. So even if students pass SLC and + 12 with good grades, if they decide to stay in Nepal, often adjustment becomes a problem for them. A large chasm is created between them and the ordinary people. Such students often become misfit in general social environment. Only advantage they have is their good verbal English. I think this is where the problem lies. The state should have a good regulatory framework and capacity to supervise what is being taught and in what way, but in no way try to impose political partisan view points like in the Communist countries or under the Panchayat Raj. Politicians should cease to use schools as recruitment grounds for their cadres, fill it with their followers as teachers and use them for party politics. There should be a law to ban recruitment of school children not only in army but also their use for party demonstrations.

One more issue pertinent for school education is the role of community-managed schools. They could replace the private schools in competition itself given proper environment. The snag is that while parents and students are willing to pay 10 times more for private education, levy of even minimum charges by the community/public schools faces strong opposition, inflamed by politicians. The VDCs could pay for really those unable to pay even the minimum in community/public schools from this Fund. Community schools can probably do a better job on this front.

(Meena Acharya)

Appendices

Appendix 1

E-seminar Theme

Nepal is at the outset of a historic political transformation which will call for a radical change in the governance structure. Domestically, we have witnessed a call for greater social and gender inclusion. Internationally, we are only beginning to appreciate the rapidly unfolding Shining India and Roaring China phenomena. What will this mean for the industrial policies and institutions in New Nepal?

Institutionally, which regulatory procedures, institutions and policies can and should adapt to the new demands of domestic populism and international marketism? Sectorally, what should be the new State policy towards the 'old' giants of agriculture *vis-a-vis* newly evolving sectors of services and manufacturing? As the State undergoes a national reconstruction process, what role should the private sector play in the tall order of infrastructure-building and global integration? And is there a politico-economic nexus in private sector development?

E-Seminar Timeline

The seminar starts with a paper authored by Ms. Mallika Shakya of London School Economics. Within two weeks, the designated discussants will send their comments. By February 15, the paper and the comments will be available for public viewing and for comments and questions from all. The e-seminar ends on February 28th**.** Those interested in participating as a part of the e-audience in the listserv will have to send you name and email by February 10 (see below for details).

The paper and the discussions and comments will appear later in a special edition of the e-journal Liberal Democracy Nepal Bulletin.

How do I participate?

You can participate in the e-seminar in various ways.

1) You can send your name and email as an interested participant if you would like to raise a question, or make comments on the paper itself or on

ensuing discussion. Your email, which will not be made public, and your name should be sent to Bishal KC: bishalkc@gmail.com, preferably by February 10. It will be entered in a temporary listserv which will be deactivated upon completion of the seminar, on February 28. Your participation within the e-seminar listserv deliberation is completely voluntary. Your substantial contribution and thoughtful writing could be displayed on the web with some editing if necessary (see: Access to Papers, Comments, & Deliberations**)**

2) Alternatively, you can check the seminar display board periodically and send your question and/or contribution to the moderator through a simple submission mechanism (see: Access to Papers, Comments, & Deliberations**).**

Collaborating Partners

This is a first of its kind e-seminar organized for the Liberal Democracy Nepal (LDN) in collaboration with the Nepal Study Center at the University of New Mexico. Liberal Democracy Nepal (LDN) is dedicated to disseminating and discussing the full range of political economy issues and ideas germane to the ideal of creating liberal democracy in Nepal. LDN is an affiliate of Nepal Study Center at the University of New Mexico, USA.

Appendix 2: e-Seminar Organization Team

Ms. Mallika Shakya is PhD candidate with London School of Economics (LSE) and is currently with the World Bank, where she has led public-private dialogues on trade, industrial innovation, and gender.

Dr. Vijaya R. Sharma, Faculty in the Economics Department of University of Colorado. He was an active member of the task force to prepare the Seventh Five-Year Industrial Development Plan in Nepal and the 1987 Industrial Policy.

Dr. Bhola Chalise is the Chairman, Board of Directors of Rastriya Banijya Bank, the largest commercial bank in Nepal. He is a former government permanent secretary and holds his PhD from University of Vienna, Austria.

Mr. Krishna Gyawali is a Joint Secretary in the Ministry of Finance, and has spent over two decades in Nepal Civil Service. He was recently a Hubert Humphrey Fellow, and worked as a consultant with the World Bank in Washington DC.

Mr. Sujeev Shakya is the President of Tara Management Private Limited, an investment and management company that manages diversified portfolio of businesses along with Bhotekoshi Power Company, Nepal's first Independent Power Producer and Surya Fund, Nepal's first private equity fund.

Mr. Prachanda Man Shrestha is Joint Secretary in the Ministry of Industry Commerce and Supplies, and has 32 years long civil service experience in the government of Nepal. He has led high-level Nepali delegations on various international platforms, including on issues of international trade and tourism.

Mr. Jagadish Upadhyay is an independent consultant on development programs, currently focusing on public health. He is a former official of Nepal's Planning Commission (1962-1971) and of the World Bank (1971-2003).

Dr. Mukti Upadhyay is an associate professor of economics at Eastern Illinois University. He specializes in development economics with a focus on macro and international aspects of development.

Dr. Alok K. Bohara is a professor of economics at the University of New Mexico (UNM), and the founder of the Nepal Study Center at UNM. His research focus is in the areas of environment and development and their relationships with poverty and conflict.

Mr. Prakash Adhikari is a doctoral student in political science at the University of New Mexico.

Mr. Naresh Nepal is a doctoral student in economics at the University of New Mexico

Mr. Bishal K.C. is a computer science professional and resides in Washington DC.

Appendix 3.

List of Participants

- Aditya Jha
- Alok K. Bohara Dr.
- Ambika P. Adhikari Dr.
- Anju Sharma
- Anup Pahari Dr.
- Bhola Chalise Dr.
- Bhuban B Bajracharya
- Bimal Koirala Dr.
- Bishwambher Pyakuryal Dr.
- Biswo Poudel
- Dharm Bhawuk Dr.
- Dharmedra Dhakal Dr.
- Gaury S Adhikary Dr.
- Girija Gautam
- Gyan Pradhan Dr.
- Hari Bansh Jha Dr.
- Jagadish Pokharel Dr.
- Jagadish Upadhyay
- Jeet Joshee Dr.
- Jeff Drope Dr.
- Jiba Lamichane
- Jugal Bhurtel Dr.
- Kamal Upadhyaya Dr.
- Keshav Acharya
- Keshav Upadhyay
- Krishna Gyawali
- Kul C Gautam
- Laxman Devkota Dr.
- Madhu Ghimire Dr.
- Mahendra Lawoti Dr.
- Meena Acharya Dr.
- Mukti Upadhyay Dr.
- Nabina Shrestha
- Narayan Khadka Dr.
- Naresh Koirala
- Prachanda Man Shrestha
- Pradip Upadhyay Dr.

- Pramod Mishra Dr.
- Puru Subedi
- Radhesh Pant Dr.
- Raghab Pant Dr.
- Ramjee Parajulee Dr.
- Ravi Bhandari Dr.
- Roger Adhikari
- Sailesh Tiwari
- Samanta Thapa Dr.
- Shankar Sharma Dr.
- Sharda Thapa
- Shyam Karki Dr.
- Sujeev Shakya
- Suman Timsina
- Surya P Subedi Dr.
- Tara Niraula Dr.
- Vijaya R Sharma Dr.
- Yuba Raj Khatiwada Dr.

Appendix 4.

Guidelines for Collaborators, Contributors and Moderators

Introduction

Nepal Study Center (NSC) at the University of New Mexico conducts research, undertakes collaborative projects to promote research and education, and runs annual policy research conference, among other things. The aim is to help understand the underlying issues in development, democracy, conflict, and the environment as they relate to the Himalayan region and the countries in South Asia. Development is broadly defined to include health, education, environment, natural resource management, governance, equity, information technology, poverty, socio-economic strives, and micro and macro economic activities.

To that end, it has developed an e-conference portal to conduct seminars on the internet within a structured environment. The idea is to bring scholars and interested participants from all over the world to a common platform for an informed deliberation. The first NSC/LDN e-seminar was conducted by the **Liberal Democracy Nepal (LDN)**: **e-Seminar No 1 2007** in collaboration with the NSC using this portal.

Scope of the E-Seminar Theme

The e-seminar topics need to have a **broader policy implication**, and the issue should be dealt in a thematically deep and rigorous manner. NSC expects collaborating scholars and experts involved in the e-seminar to 1) lead the discussion, 2) moderate and edit deliberations, and 3) be involved in the preparation of the proceeding.

Interested parties can contact the Nepal Study Center for such collaborative projects. A typical e-seminar can last for about 2 to 4 weeks, and the final output is published as a proceeding in one of the two journals of the NSC (HJDD or LDNB). A basic structure and the ground rules are given below.

Basic Ground Rules and Logistics

Email Privacy: To avoid spam and also due to some requests, every effort will be made not to make the participants' emails public during or after the deliberation. Email address of the e-seminar members within the listserv group deliberation will be kept hidden. It is up to the e-seminar members to reveal their individual email address as a part of their name signature. We do require however that the deliberating members sign their submissions with the name and a line or two about the profession and/ or the professional affiliation.

Access to Papers and Seminar Deliberations: All the papers, comments, and deliberations from the e-seminar floor will be posted by the moderators publicly on the NSC's e-seminar display and archival site.
E-seminar listserv etiquette: Participants are expected to be issue oriented, focused on the seminar topic, show civility, and be courteous to each other. The e-seminar discussion forum (within the listserv exchanges) may not be used for personal greetings and non-seminar related queries and other postings.

Role of Moderators: The e-seminar moderators will reserve the right to remove postings that are not relevant to the topic under discussion. Because of the amount of work involved, we encourage at least two individuals to act as co-moderators. Moderators shall make every attempt to post the comments/contributions at least once a day.

Moderators are required to maintain quality of deliberation by being alert and engaging. Moderators may also have to screen and/or edit the submitted comments especially during the second week of the floor deliberation before it goes for the public posting. Moderators also reserve the right to exercise their discretion and take actions, if necessary, to facilitate the smooth running of the e-seminar.

E-seminar Operational Structure

There are three phases in this e-seminar structure: initial preparation (1/2 weeks), deliberations (1/2 weeks), and publication of the proceedings (1/2 week). Some minor modification could be negotiated between the collaborating partners.

Initial Preparation (1/2 weeks)

Interested collaborating partners should contact the Nepal Study Center with 1) seminar topic, and 2) a tentative list of scholarly panelists. Prior to starting the actual e-seminar deliberations, presenter's papers are made available to discussants, and the discussants provide their comments before a certain deadline (typically in two weeks).

The length and the number of papers to be considered for the e-seminar deliberation will depend on the topic and the panelists. Apart from the individual papers, they will as an opening statement: (i) introduce the theme, (ii) lay out relevant issues and questions, and (iii) set the frame for the e-discussion. The length of the comments from the discussants is flexible, but needs to be crisp and focused on the presenter's presented theme and papers.

E-Seminar Deliberations (1/2 weeks)

Typically an e-seminar on a particular topic may last for up to two weeks. The deliberative phase can be broken into two sections.

Phase I: Interactive Deliberation

First week/Panelists: E-seminar begins with the simultaneous posting of the papers and the discussants' comments. (The requirement of simultaneity may be relaxed). The panel (presenters and the discussants) deliberates and provide rejoinders by using the listserv based email exchanges. The deliberated materials are collected, edited (if needed), by the moderators and made available for viewing. The deliberation can be confined to the panel members for this phase. Other registered participating members of the e- listserv group can view the discussions and take notes.

Phase II: Floor Discussion

Second week/Question-Answer from the Floor: The floor opens for questioning, and the e-participants are encouraged to present their views and ask questions for the panel. Engagement is voluntary however. The deliberated materials out of the e-seminar floor within the e-seminar listserv group will be edited for quality consistency and made available for public viewing.

During these two weeks, the moderators will regularly post contributions emerging from the e-discussion out on the web for public viewing, and they will also entertain submissions from others from around the world who may be following the e-seminar discussions on the web. (See: Access to Papers, Comments, & Deliberations)

The time frame between the phase I and phase II could be adjusted by the moderators. Typically by the end of the second week, the e-seminar ends. The listserv created for a particular e-seminar is disabled.

Publication and Dissemination of e-seminar proceedings (1/2 weeks)
A special e-seminar proceeding can be prepared by the guest editors (e.g., some members of the panelists), and may be submitted for publication in the Nepal Study Center's e-journals **Liberal Democracy Nepal (LDNB)** journal, or **Himalayan Journal of Development and Democracy (HJDD)**. But the quality of the proceeding must be assured by the e-seminar moderators and the guest editors. This platform will also try to archive past e-seminar deliberations.

Appendix 5

Nepal Study Center: was established at the University of New Mexico two years ago with an objective to promote policy research activities related to the Himalayan region, Nepal, and the countries in South Asia. NSC takes this policy research theme broadly to include issues related to development, democracy, governance, conflict and the environment. NSC is dedicated to creating platforms to enhance knowledge sharing.

NSC's research capacity-building activities include two e-journal publications (Himalayan Journal of Development and Democracy and Liberal Democracy Nepal Bulletin), the annual Himalayan Policy Research Conference, e-seminars, and maintaining an electronic repository to allow scholars to upload, store, and disseminate policy research. For details: http://nepalstudycenter.unm.edu

Liberal Democracy Nepal: is dedicated to deliberating and disseminating the full range of issues and ideas dedicated to the ideal of creating liberal democracy in Nepal. Based at the Nepal Study Center at University of New Mexico, LDN is a forum consisting of scholars, professionals, and policy practioners. Issues of fundamentals reforms and political economy are addressed in the Mission and Theme section. In summary, LDN focuses on:

1. Showcasing, deliberating, disseminating, and archiving relevant papers, proceedings and reports on contemporary topics related to socio-economic issues, fundamental reforms, state restructuring, and political economy that are of importance in promoting liberal democracy in Nepal

2. Conducting seminars and workshops, and publishing selected contributions, articles, discussion materials, and constructive comments in Liberal Democracy Nepal Bulletin (LDNB) journal published by the Nepal Study Center

3. Networking with scholars and professionals in Nepal for joint collaborations and deliberations in areas related to fostering liberal democracy in Nepal. For details: http://www.liberaldemocracynepal.org