

Trade, Private Sector Development and Investment Opportunities



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Presenters

Mr. Purushottam Ojha, Secretary
Ministry of Commerce and Supplies

Mr. Pratap Kumar Pathak, Secretary
Ministry of Industry

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1. Introduction

Government of Nepal (GoN) has recognised the importance of the role of the industrialization process in reducing unemployment and thereby, the poverty. It is believed that apart from reducing the dependence on the subsistent agricultural sector, it can maintain balance on trade and increase the contribution of industry to the national economy and hence unleashing prosperity. GON has also recognised the fact that with the selective policy interventions for the Private Sector Development (PSD), the desired economic growth can be achieved. It is believed that a vibrant private sector is a critical component of economic growth and sustainable development. Thriving businesses create jobs and the jobs provide incomes. Steady incomes reduce poverty and create opportunities for new generations. That is to say, with the targeted PSD strategies GoN can achieve the Millennium Development Goal (MDG) of halving the proportion of people living in extreme poverty.

However, despite the persistent efforts of the GON, industrial growth in the country has not taken the expected pace. While the Tenth Five-year Plan document had set target of increasing the contribution of industrial sector to 9.32 percent of the Gross Domestic Product (GDP), only 8.4 percent growth could be achieved. Likewise, the Plan had set the target of 7.8 percent growth rate in the industry sector, the actual growth rate turned out to be only 1.95 percent. Similarly, merchandise export during the Plan increased only by 0.5 percent vis-a-vis the growth of imports by 8.7 percent. As a consequence, as against the set target of limiting the trade deficit within 12.2 percent of the GDP, it instead rose to 15.1 percent¹.

The Tenth Plan had envisaged increasing the contribution of the industry sector to the GDP through an increase and expansion in industrial production by encouraging and promoting the private sector. It was expected that private sector as the engine of growth would, through their increased entrepreneurial activities and gains, support in reducing poverty by means of creating the opportunities of employment and self employment and thus contributing to raise income level of the poor. Moreover, the Plan had set the goal of attracting Foreign Direct Investment (FDI) and appropriate technology in areas with comparative advantage in order to further industrial competitiveness.

Industrialisation in Nepal is in its early stage and it is, therefore, no wonder that Nepalese products have been losing competitive strength at domestic and international markets owing to numerous problems. The domestic industries and fledgling enterprises are adversely affected because of a number of constraints such as its geophysical position, lack of adequate physical infrastructure, political instability, social conflict, deterioration in industrial security, rigid labour market, high infrastructure cost, high transaction costs, lack of amicable industrial relation, small size of domestic market, low capacity utilisation, lack of domestic resource base, lack of qualified manpower, low level of technology development, limited forward and backward linkages, limited inflow of foreign capital and investment, lack of business enabling environment and so on.

Nepalese industries are not only facing stiff competition due to the trade liberalisation process that the GoN has embarked upon, they are also being affected by various non-tariff and technical barriers to trade imposed by importing countries as well as other domestic problems such as lack of infrastructure for export trade, lack of quality consistency of exportable goods, inadequate trade related policy and legal reforms, heavy dependency on a single market, limited products in export basket, higher transaction cost on export trade, porous borders and unregulated entry of low quality foreign goods at cheaper prices and so on. In the meantime, current recession worldwide has added anxiety to developing countries from growing wave of neo-economic nationalism and protectionism in developed countries.

Furthermore, new opportunities and challenges have cropped up as a result of Nepal joining the World Trade Organisation (WTO) in 2004 and also regional arrangements such as South Asian Free Trade Agreement (SAFTA) and Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation-Free Trade Area (BIMSTEC-FTA). While one may argue that industrialisation process in

¹ Three Year Interim Plan (TYIP) Document, National Planning Commission, 2008.

Nepal is at low ebb, the need for proactive policies and strengthening of suitable institutions requisite for enhancing competitiveness of industrial sector through the private sector development cannot be ruled out. This in turn has led to the realization that trade, investment and related domestic policies, which are de facto developed and implemented independently by various government bodies, need to be made more coherent if one is to achieve a more sustainable and inclusive growth through private initiatives and foreign investment, as well to maintain a country's competitiveness in the global economy.

Against the above backdrop, this paper attempts to analyse the policy objectives and strategies adopted by the GoN in promoting trade and investment, specific activities that need immediate attention to promote private sector led economic growth, propose the areas of cooperation between the GoN and potential donors to enhance trade and investment, the action plan to implement the suggested activities.

This paper is organised into nine sections. The next section presents the status of trade, industry and investment situation in Nepal including the initiatives taken by the GoN to promote these sectors. The third section discusses the lessons learnt from the past activities that were geared towards promoting the trade, industry and investment in the country. The next two sections, fourth and fifth, dwell upon the policy and strategies adopted by the Three-Year Interim Plan (TYIP) for the promotion of industry and trade specific sectors. Sixth section identifies the areas that need close attention of the GoN (planned activities) for promoting the trade, PSD and investment while the seventh section enlists the areas of potential cooperation between the GoN and donor agencies which is the prime objective of this paper. It also highlights the action plan as to who should implement the program and the duration to undertake the planned activities.

2. Status of Industry and Investment

Nepal opened up its economy to outside world in the second half of the twentieth century and since then it has been exposed to vagaries of international trade. Since the late 1980s and subsequent restoration of multi party democracy in 1990, Nepal's development policy has been emphasizing on greater integration of its economy into world economy, that is a sharp departure from the historic prominence of closed-economy. The new Industrial Policy brought in the package of fiscal stimulus for industrial and trade sector like, removal of the requirement of import licenses, full convertibility of Nepalese Rupees, liberalization to open joint venture financial institutions, announcement of Foreign Investment and One Window Policy etc. were some of the important measures taken by the GoN to open up the economy and to enhance the private sector led growth. The liberalization of the economy after 1990 along with the favourable trade treaty concluded with India, which provided duty free access of Nepalese products on non-reciprocal basis into Indian market, has further accelerated the economic interactions and is likely to be intensified in future. In this section, it is attempted to give insight on the major the initiatives taken by the GoN to promote the private sector led growth in trade and investment along with the achievements following the adoption of economic liberalisation policies by the GoN in late 1990s. For the sake of simplicity they are grouped under two sub-groups and discussed briefly in subsequent paragraphs.

2.1 Initiatives

- Some of the policy and legal mechanisms that have been developed for effective promotion of trade and industry and facilitation to the private sector in the country lately are the enactment of Competition Act, Insolvency Act, NRN Act, new Company Act, Cyber Act etc. The SEZ Act and BoI Act are in the offing. They are expected to develop a healthy and competitive market, stimulate private investment and establish good corporate governance.
- Industrial and Foreign Investment Policies are being appraised in line with the newly formed federal democratic republic government's economic policy of public-cooperative-private partnership cherished in the common economic programme of the present coalition

government. They are being built around simplification of procedures, promoting technology transfer, attracting more investment, transparency in implementation and improvement of productivity through the up gradation of technical know-how and efficiency of the industries in order to enable private sector compete in the competitive world market by making use of comparative advantages of the country.

- Likewise, Micro Enterprise Policy has been promulgated. Micro Enterprise Development Project has promoted more than 30,000 entrepreneurs since its inception. The Project has been implemented in 30 districts focusing the remote and marginalized districts of Karnali, Seti and other Zones and the Project is being extended to all districts of the country.
- The process of privatisation of commercial enterprises under the domain of government/public sectors has been initiated. As of FY 2006/07, as many as 27 Public Sector Units (PSUs) have been privatised². This comprise of about 40% of total PSUs. Most of these units comprise of manufacturing establishments. The privatisation process is on to privatise more viable units.
- The process of setting up the Special Economic Zones (SEZ) has been under focus. The construction of EPZ is nearing completion at Bhairahawa while preliminary ground work has been completed for setting up such units at Birgunj, Kakadvitta and Panchkhal. The enactment of SEZ law is in the offing and very soon an ordinance to that effect is expected.
- Build-operate-transfer (BOT) Act has been enacted to promote the private sector investment in infrastructure projects.
- To attract internal and foreign investments, the act related to Non-Resident Nepalese (NRN) has been promulgated and the process of formulating the corresponding regulation is underway.
- The process is on to institute the Board of Investment with participation of private stakeholders with the broader objective of facilitating private sectors' participation in large industrial and infrastructure projects.
- Incubation services considering the development of young entrepreneurs have been started with the initiatives and collaboration with the private sector for entrepreneurial development.

2.2 Performance

- The performance of the manufacturing sector in Nepal shows rather a mixed picture. After a policy of economic liberalization was adopted in 1986, the manufacturing sector made a promising start with real growth rates averaging around 9 percent at the end of the eighties and early nineties, even reaching above 20 percent in 1991/92. Since then, however, real manufacturing growth declined to become even negative in the year 2000/01³. Currently, the contribution of manufacturing to GDP is in the order of 7.1 percent, a decline from about 9 percent from the year 2000/01. In addition, the growth in the contribution of

² Nepal and the World, A Statistical Profile, FNCCI, 2007:156

³ Industrial Development Perspective Plan: Vision 2020, UNIDO, 2002

industry sector to GDP is estimated to shrink to 0.18 percent in F.Y 2008/09 from the 2.55 percent of the preceding year.

- The first year (FY 2007-2008) of the Three-Year Plan Period has been able to bring Rs. 9.8 billion worth of foreign investment from 214 approved projects, about a quarter of which is approved for hydro power sector. The manufacturing sector is able to attract about 13 percent of the total investment. Likewise, the local investment worth of Rs. 15 billion is approved for 227 medium and large industries during this period. Nevertheless, of them only 68 industries are of medium and large scale. Close to 9,500 small and cottage industries are registered with the investment of about Rs. 8 billion. A study shows that, however, only about 25 percent of registered small and cottage industries tend to be realized. Large industries like, cement, paper, iron and steel, textile and yarn and sugar Mills have suffered from the low capacity utilization of around 50 percent, which can be attributed to the inherent systematic and labour problem as well as power shortage.
- Amongst the manufacturing sector, small and medium enterprises (SMEs) form the backbone of Nepalese industrial sector as they were largest in numbers, are widespread and have 'high employment intensity'. According to the latest national level Census of Manufacturing Establishments conducted in the year 2001/02 covering manufacturing industries that engage 10 or more persons, out of a total of 3,212 of such establishments SMEs were 3,091 (96.2 per cent). They provided employment to 139,562 persons (77.8 per cent), had gross fixed asset investment of Rs. 12,079 million (29.9 per cent), and had census value addition of Rs. 14,946 million (45.8 per cent). Although most of the micro industries are located in rural areas, however, only 50 percent of manufacturing industries are located in those rural areas. Nepalese SMEs were found to be labour-intensive as they created a job by investing Rs. 86,552 on fixed assets while the larger firms created each job for Rs. 667,563. SMEs in Nepal are the largest employer outside the agricultural sector in rural areas.
- Comparing the Industrial Censuses of 2002 and 2007, the results appear not that promising. The number of industries engaging ten or more workers stood 3,212 in the year 2002, whereas it had a minor increase to 3,646 in 2007. However, the number of workers has decreased from 191, 852 to 177,550 during the review period. Likewise the number of industries registered with the Department of Industries in recent years has also decreased from the ever high of 607 in 1992/93.
- By the end of November 2008, permission has been granted to establish 1,591 industrial projects on joint venture basis and/or 100 percent foreign investment and/or for transferring the technology to these industrial projects. The total project cost of such projects is Rs 121 billion, out of which foreign component is Rs 46 billion. The individuals/firms of 58 countries have invested in Nepal⁴. Out of these, about 1,400 industrial projects have been approved after the promulgation of the Foreign Investment and Technology Transfer Act, 1992 (FITTA) and Industrial Enterprises Act, 1992 (IEA).
- Table 1 is self explanatory in indicating the deteriorating quality of foreign investment inflow in recent years. The concentration of investment by sector is in the service and tourism related business, which require not as much of capital and contribute less to employment, value-chain and national exchequer. The size of investment has also declined

⁴ Department of Industries

in terms of prevailing real exchange rate between those two periods despite an increase in the number of projects in the latter period.

Table 1: Sectorwise Inflow of Foreign Investment- A Comparison between F.Y 2000/01 and 2006/07

Area of Investment	Number of Projects		Share of Foreign Investment (Rs. in Million)	
	FY 2000/01	FY 2006/07	FY 2000/01	FY 2006/07
Agro-based Industries	1	1	10.0	5.0
Construction Industries	-	5	-	78.2
Energy-based Industries	3	1	395.6	30.3
Manufacturing Industries	54	44	1816.0	1897.9
Mineral-based Industries	-	1	-	10.0
Service Industries	19	81	343.1	938.2
Tourism-related Industries	19	55	537.9	267.1
Total	96	188	3102.6	3226.7

Source: Department of Industries

- Table 2 reflects the contribution of FDI in Nepalese economy. Both, from the perspective of its share to gross fixed capital formation and GDP, FDI in Nepal has its lowest role in South Asian realm.

Table 2: Contribution of Foreign Investment (FDI) Inflow to GDP in South Asia

Country	Share of FDI in Gross Fixed Capital Formation (in percent)			FDI Share in GDP (in percent)		
	Year 2003	Year 2004	Year 2005	Year 1990	Year 2000	Year 2005
Nepal	1.3	-	0.4	0.3	1.3	1.7
Sri Lanka	5.7	4.7	5.2	8.5	9.8	10.4
India	3.4	3.1	3.5	0.5	3.8	5.8
Pakistan	4.2	7.5	13.0	3.6	9.8	8.8

- Table 3 suggests that Nepal is also at the bottom in this region from the consideration of adding to value chain in industrial activities. It implies that either Nepal's major industries are foreign raw material based or there exists only a limited operation in industrial processing at firm level.

Table 3: Nepal's Performance in Value Addition among South Asian Nations (In Percent)

Country	Year 2004	Year 2005	Year 2006	Year 2007
Nepal	17.3	17.1	16.7	16.7
India	28.2	28.8	29.3	29.4
Bangladesh	26.6	27.2	27.9	28.5
Sri Lanka	28.8	30.2	30.6	29.9

- Nepal's current comparative advantage in international trade lies in resource-intensive and labour-intensive product areas. Today, 95 percent of manufactured exports are concentrated in these categories. Following list of Nepal's exports that meet the *revealed* competitive advantage test in world markets: dried leguminous vegetables (lentils), spices (large cardamom and ginger), leather and leather products (hides and skins and blue chromes), fabrics (hand-knotted wool carpets), yarn and textiles (polyester yarn), garments and non-apparel textiles (ready-made garments, knitwear and (pashmina shawls, mufflers⁵). While growth has been rapid in these areas, the country's global market share is still extremely low, suggesting significant room for growth.
- Some progress has been made in infrastructural development at Bhairahawa EPZ and preliminary work for land consolidation and fencing of the acquired land has been initiated in Birgunj SEZ. SEZ Bill is in discussion at higher level. The Nepal Bureau of Standard is being strengthened with EU-WTO assistance to develop it as the effective national standard body. In addition, Department of Mines and Geology has initiated actions for promoting Surkhet Limestone Deposit, Kathmandu Natural Gas Deposit, Kalitar (Makwanpur) Copper Deposit and Gandhari (Dang) Limestone Deposit, among others.
- Dry ports have been constructed at Birgunj, Bhairahawa and Biratnagar in order to expedite the transport of commercial goods and to reduce the cost of foreign trade through simplification in the procedures.

3. Lessons Learnt

As can be observed from the discussions presented in the preceding section, the main thrust of the policy reform initiatives taken by the GoN have been geared towards promoting the investment, and hence the industrial output and trade through private-sector led growth model. These initiatives have bore the fruits to some extent. However, there are still many challenges that need prime attentions and must be addressed. Some of these challenges are briefly discussed in following paragraphs.

- The gains from trade and global integration of a country depend largely on the competitiveness of that country's economy i.e. how efficiently it can produce goods and services and how strategically it offers them in the world market. Nepal's accession into the multilateral and regional trading arrangements has brought both opportunities and challenges with it. While these twin processes of globalisation and liberalisation have made Nepal an attractive destination for investment and opened up new markets to Nepalese industries, they have also enhanced competition in the domestic market, but has not been able to take advantage of the opportunities proffered by the global integration. At the domestic front in accordance with its commitment, GoN has lowered or completely eliminated tariffs and systematically dismantled non-tariff barriers imply that Nepalese industries are experiencing threat from imported products. In this context, development of the private sector and enhancement of competitive ability needs greater attention amid changing global and regional business environment than ever.
- Despite economic liberalization and growth of trade, the competitiveness of Nepal's economy is very low and labour productivity is among the lowest. Nepal ranks very low in

⁵ Nepal: Trade and Competitiveness Study, 2003, World Bank:48

the global competitiveness index indicating low level of institutional environment, infrastructure, markets and technological innovation. Out of the 125 countries included in the survey, Switzerland ranks first with the score of 5.81 while Nepal ranks 110th with a score of 3.26 (WEF, 2006).

- While the number of SMEs registered in 2001 reached to 65,875 their mortality has been high. According to the information provided by New Business Age (April 2004 issue), 25 percent of such registered enterprises do not start up at all while another 50 per cent close down before the fifth year of their operation.
- Majority of SMEs are primarily concerned with the marketing constraints they face in export market. Their international competitiveness is seriously impaired by their disadvantageous economies of scale, lower technology level, limited domestic technological capacity, and limited access to financial and other input resources. Moreover, delivery uncertainty due factors such as labour disputes and internal political rift, high transaction costs due to geophysical situation (landlocked), inadequate domestic capacity to face the international commercial disputes, varying sanitary and phytosanitary requirements and higher technical and packaging requirements of export markets etc. have put them in disadvantageous position.
- Nepalese industries do not have the ability or inducement to acquire and use new technology because of the absence of strong technology-transfer mechanisms (in-firm training, business support, and foreign direct investment (FDI), which are key to raising productivity. Lack of business support services for training, technical assistance, and market information is a major handicap in raising firms' technical capabilities. Furthermore, labour market rigidities provide little incentives for firms to invest in training as shown by the research on the determinants of productivity in Nepal⁶.
- Nepal needs more access to foreign direct investment (FDI), a key conduit for transferring technology. FDI can be a major contributor to the economic growth and social development as foreign investors bring in new skills, know-how and technology. Through sub-contracting and other forms of collaboration, they can cherish local firms to gain access to global supply chains and international markets. The quality that they expect from local suppliers and the world-class standards they introduce, may encourage the learning, technology upgrading and innovation that these firms need if they are to become competitive in world markets.

The past initiatives and lessons learnt, as discussed in previous sections, point towards the need of a greater role for the private sector with the government acting as the facilitator and the guardians of the economic actors. The learnt lessons also indicate the areas where government needs to improve upon to facilitate the entry of the private sector to boost the investment so as to broaden and strengthen the industrial base and hence boost the domestic and international trade for the general welfare of Nepalese people. In this context, it is necessary to examine how the GoN intends to overcome the challenges and promote the trade and investment sector in the country.

⁶ Industrial Development Perspective Plan: Vision 2020, UNIDO, 2002

4. Challenges for Building Enduring Industrial Base

Amidst adversities, Nepal has been facing the following challenges to build enduring industrial base:

- Instability in political arena and unpredictable investment as well as industrial policy,
- Poor infrastructure, especially power, transport and industrial and trade infrastructure,
- High costs due to terrain and poor transport network,
- Weak institutions, absence of rule of law,
- Restoring peace and security, especially in Terai Region,
- Absence of investment friendly labour policy and workforce, lowest productivity,
- Problems of technology up-gradation and transfer,
- Fast changing import policy and unwillingness of major trading partner to award duty-free access to Nepalese commodities in their markets despite benefitting from huge bilateral trade surplus,
- Slow progress in pursuing second-generation policy reforms.

5. Policy Objectives

In coherence with the basic tenets of the government economic policy of double digit growth in the medium term and evolving development paradigms aspired by the people at large complemented by a solid foundation of industrial growth in the process of making new Nepal, following industrial development objectives and strategies are laid out.

Objectives:

- With common efforts of private sector and cooperatives, develop sustainable and broad-based industrial sector able to contribute significantly to the national economy
- Support poverty alleviation with the target of promoting social inclusion in industry by means of micro, cottage and small industries development
- Deepen attention to micro-economic and other supporting policies aiming at developing base for enlarged investment in order to establish Nepal as a hub of safe and profitable investment
- Devolve and strengthen industry supporting institutions at regional level to prop up industries using local materials, other resources and skills in order to facilitate balanced regional development
- Foster sustainable and competitive industrial enterprises with the adoption of new technologies and environmental production process reducing cost and improving productivity and competitive strength
- Develop investment friendly, productive, skilled labour and managerial level workforce.

6. Sectoral Strategies and Planned Activities

The agenda that seek to promote PSD, and hence investment and trade, are based on some key premises such as stable macroeconomic management; investment, trade, and price liberalization; reduced barriers to competition; well-functioning financial and capital markets; flexible labor and land markets; good physical, social, and technological infrastructure; equitable tax systems; legal and judicial systems that protect property rights, enforce contracts, and provide for dispute resolution. In addition, the policy agenda will include measures to maximize the benefits of globalization (e.g., increased trade and capital flow) and minimize the risks associated with it (e.g., sudden and disruptive movements of short-term capital). This will require, for instance, the introduction of regulatory frameworks to strengthen market institutions and establish social protection programs, including social safety nets and labour laws that protect workers.

Some of the key specific activities that are planned to promote trade and investment with active participation of the private sector are discussed in subsequent paragraphs. It may be noted for the sake of simplification, that they are grouped under three broad categories which may be termed as 'Thrust Areas', namely, enabling policy and institutional environment, capacity building and productivity measures and the creation of physical infrastructures. Each of these Thrust Areas is being briefly discussed in subsequent paragraphs.

6.1 Enabling Policy and Institutional Environment

The followings have been identified as the core areas requiring attention to enable the private sector to assume greater role in boosting the trade and investment.

- The competition of the domestic industries with the substandard and dumped imported goods needs to be managed through custom duties, anti-dumping duty and equalizing/countervailing duty and using the competition provisions.
- Identify the sector(s) or sub-sector(s) on which to focus efforts to boost export performance through industrial upgrading, productivity enhancement and enterprise restructuring. Accordingly, it is necessary to design an effective export strategy targeting the right industries. The process starts with an analysis. Building-up a competitiveness analysis programme which helps to identify those sectors and products in which Nepal has the greatest competitive potential and in which it would have comparative advantage.
- Pursuant with global trade regime there is a need to focus on identification, development, and production of export items with comparative advantages based on climate, biodiversity and topography of the country.
- In order to reduce transaction costs related to trade, there is a need to create additional physical infrastructure; and reform and upgrade the existing rules and procedures and create new laws that facilitate the rule-based fair trade. It is, therefore, necessary to identify the reform areas and creation of additional policies and laws.
- For the promotion of exports, various promotional programs and incentives are to be identified and implemented with the involvement of the private sector.

- In order to utilize the opportunities emerging from international and regional trade agreements, there is a need to concentrate on the matters where the Nepalese industries should work on so as to meet the Rules of Origin (RoO) criteria and other provisions of such agreements.
- Mutual compatibility and acceptance is to be ensured by making procedures of custom, transit, and quality certification, standards and regulations/rules.
- Efforts to facilitate the entrance of foreign investment and technology in the areas of comparative advantage and priority sectors have to be made by creating an investment friendly environment.
- In order to upgrade the technology absorption level, it is imperative to formulate technology policies and strategies that guide the development of the technological infrastructure and its widespread dissemination. There is also a need to identify the requisite incentives and assistance needs of the private sector in this area.
- Appropriate facilities and incentives have to be provided to attract national and foreign investment in the development and expansion of industrial infrastructure. For the protection and promotion of the private sector investment in such area, it should be ensured that:
 - Facilities and incentives will be provided to investments at least at par of those being provided by neighbouring countries and other competitive countries and economies.
 - Procedural matters related to the investment are simplified, regularised and made more transparent.
 - Identify the policies and laws that contradict or are not compatible with the trade and investment policies or laws and take corrective actions.
- In a country like Nepal, private sector investments alone cannot meet the investment needs of the country and hence a closer partnership between the public and private sectors—and a sensible division of roles between them—is essential to support sustainable development, reduce poverty, promote equity, and ultimately achieve greater prosperity. Hence, there is a need to formulate suitable policy wherein the concept of Public-Private-Partnerships (PPP) can work effectively.
 - PPP in physical infrastructure can take the form of BOT projects where there is a sharing of risks between the public and private sectors, with each risk being allocated to the party that can best manage it. PPPs can be enhanced when the private sector undertakes a BOT project and the government provides complementary support infrastructure (e.g. or transmission lines to evacuate power from a BOT generating plant).
- Initiate corporate sector reforms so as to develop the responsible corporate governance mechanism. It can be done by reviewing commercial laws and regulations, and establish (i) credible accounting and auditing standards; (ii) timely and accurate disclosure rules; (iii) sound environmental, labour, and social standards; (iv) provisions for adequate

protection of minority shareholder rights; and (v) effective bankruptcy and foreclosure regimes.

- Industrial security force will be organized to ensure rule of law, peace and security in the industry sector.
- Programs related to micro, cottage and small industries have to be implemented by targeting the extremely deprived and socially excluded groups, and those below the poverty line selected from the designated rural communities.
- Venture Capital Fund has to be established in order to help new enterprises and investment in the form of equity and to encourage them.
- Necessary measures to be taken for improving access to finance for under-served groups such as micro, small, medium and rural enterprises.
- Measures to be taken to develop the industrial business clusters in order to facilitate the creation, promotion and development of micro enterprises and SMEs.
- Efforts should be directed in building the sustainable linkages between small-size enterprises, their larger scale business partners and support institutions. There is a need to develop and implement a national policy on ‘Subcontracting’.
- There is a need to devise the measures to increase the domestic value addition in export products through forward, backward and lateral linkages of the exportable industries with the other sectors of economy such as agriculture, forest, mining and tourism etc.
- Greater attention is to be paid to improve labour market operations so as to promote employment opportunities for the poorer and improve their productivity level.
- Laws related to Intellectual Property Rights (IPRs) should be updated/enacted by encompassing the provisions of the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS).
- In order to get greater benefit from the international networks, Nepal should become members of Patent Cooperation Treaty (PCT) and Madrid Protocols.
- Suitable policy is to be formulated, and integrated into the relevant laws, to ensure green productivity and adoption of cleaner production technology.
- There is a need to devise the policy to encourage the establishment of industrial clusters in the periphery of SEZ. Similarly, needs of the industries that support the industries situated in SEZ should be identified and implemented.
- In order to attract FDI and boost export trade, there is a need to organise an Investment Forum on ‘Trade and Investment Opportunities in Nepal’.

6.2 Capacity Building and Productivity Enhancement Measures

- There is a need to encourage and support the enterprises in the domain of technology management and technology transfer that leads to enhanced competitiveness, productivity and growth.
- It is necessary to ensure effective quality determination, certification and proper measurement standards to protect the interests of industry and consumers. For this, the institutional capacity of Nepal Bureau of Standards and Metereology (NBSM) and the Department of Food Technology and Quality Control needs to be improved. Likewise, the institutional capacity of the private sector in this area should also be enhanced.
- The institutions engaged in entrepreneurial education and business incubations need to be supported to help develop a sound SME environment. Focus of such institutions should be on the development of entrepreneurship among potential young entrepreneurs, women, socially deprived communities and those belonging to rural areas of the country.
- There is a need for strengthening the capacity of Ministry of Industry (MoI) and that of Ministry of Commerce and Supplies (MoCS) in policy formulation, planning and research in commensurate with the global and regional business trends.

The dynamic nature of industries and trade necessitates sustained and continuous actions at policy level. Policy-related economic analysis covering activities such as competitiveness analyses, the setting up of knowledge banks and design of best practices and benchmarking systems have to be undertaken to promote new competitive businesses and productivity. Furthermore, there is a need to attract the private sector to promote industrial enterprises that drive the economic growth process and foster entrepreneurship, technological dynamism and associated productivity growth.

Similarly, the dynamic nature of industrial competitiveness makes it necessary for stakeholders to monitor continuously the progress of strategies and policies and to measure their performance against that of regional neighbours, other developing countries and industrialised nations. This is exercises which is “learning by monitoring” in nature, so as to fine tune and improve the strategies. The results of this analysis should also feed into decisions on industrial policy and strategies that strengthen the competitiveness through raising productivity and managing the domestic ventures accordingly.

Because global competition is tough, a high quality product may still lose its competitive edge if the support environment (regulatory framework, business infrastructure) is inadequate. The creation or upgrading of that support environment is essentially a joint venture between the public and private sectors, with government playing a key role in creating an environment conducive to trade.

- The success of any PPP program is dependent, to a large extent, on the strength of the institutions which service that mechanism, both public and private. Hence, the institutional capacity building of both is necessary to devise and implement projects or programs successfully under PPP.

- Despite realising the importance of FDI in national development, the flows of investment and technology have not materialized to the extent expected. Nepal has not been able to attract quality investments that support its development goals. Moreover, there is a poor record of forming linkages with domestic suppliers and stimulating their development. Appropriate forms of FDI are not identified and targeted. This situation largely reflects the problems arising from government and market failures and weaknesses in institutional capacity, which together make for a business climate not conducive to investment and technology promotion. To address these government and market failures in a systematic manner, there is a need to establish a network and databases to help the foreign investors to draw on the platform to identify growth areas.
- Data on the investment climate and business opportunities is usually fragmented and insufficient for informed decision-making. The market-supporting institutions that should provide accurate public information and enable market agents to assign resources efficiently are lacking. Hence, there is a need to build the necessary capacity for the successful delivery of supporting services in collection, processing and diffusion of quality business-related information.
- Strengthen the institutional capability to organise the investment promotion related activities and investment seminars.

6.3 Creation of Physical Infrastructure

- In order to get greater benefit from the knowledge that exists in public domain so as to enhance the domestic technological capabilities, the Patent search centres should be established at different industrial clusters in the country.
- The up-gradation of physical infrastructure of the Nepal Bureau of Standards and Metereology (NBSM) and Department of Food Technology and Quality Control so that they become internationally accredited laboratories and whose certification are recognised by the importing countries of Nepalese goods.
- Establishment of business incubators at different parts of the country and such centres be equipped with requisite physical infrastructure, including plant and machineries.
- Creation of infrastructure for the collection, processing and diffusion of quality business-related information to the prospective investors.
- Development of SEZs at Birgunj, Kakdvitta, Panchkhal, Dhangadhi etc for export oriented and supporting industries with the participation of private sector and foreign investment.

GoN believes that in the medium to long run, private sector should take initiative to establish such facilities. The immediate objective of the GoN is, however, to create such facilities that will have strong demonstration effect and replicable by private sector.

7. Potential Areas of Cooperation with the Donors

In commensurate with the global trend, GoN recognises that when properly regulated and operating under competitive market conditions, the private sector can generally use resources more efficiently than the public sector. Private sector entities can deliver goods and services to

meet growing demands and create job opportunities in this process. Public sector involvement in the productive sectors is often unsustainable, especially if it is at the expense of social sectors where it is truly needed. While government should shift away from commercial business, it has to develop a strong capacity to create and sustain the legal and market institutions needed to enable and regulate private sector activities.

Hence, there is a need for creating the enabling environment for domestic and foreign private investors and shifting the role of government from owner-producer to facilitator-regulator, and the large adjustment costs associated with such a shift, are big challenges. In the previous section, the thrust areas have been identified which requires the close attention of the GoN. Since, GoN alone cannot implement all the identified issues, it solicits the donors' continued and intensified support in some of the key areas which are briefly mentioned below.

7.1 Cooperation in Policy Formulation

- Help in designing an effective export strategy targeting the right industries which are/can be competitive at regional and global level. Identify the areas where the Nepalese industries should work on so as to meet the Rules of Origin (RoO) criteria and other provisions of bilateral, regional and multilateral trading agreements.
- Help identify the gaps in existing mechanisms to ensure mutual compatibility and acceptance in customs procedure, transit, and quality certification, standards and regulations/rules.
- Identification of the areas of comparative advantage and priority sectors and devise the strategies to facilitate the entrance of foreign investment and technology in these areas.
- Help formulate the technology policies and strategies and identify the requisite incentives and assistance that guide the development of the technological infrastructure as per the need of the private sector.
- Help formulate suitable policy wherein the concept of Public-Private-Partnerships (PPP) can work effectively, especially in infrastructure projects.
- Assist in devising the policy for corporate sector reforms so as to develop the responsible corporate governance mechanism. Likewise, assistance in formulating anti-dumping policy and countervailing measures to nurture domestic industries from unhealthy business practices.
- Assist in creating the Venture Capital Fund.
- Help identify the needs of the industries that support the industries situated in SEZs and devising the policies that encourage industrial clustering.
- Extend help in organising an Investment Forum on 'Trade and Investment Opportunities in Nepal'.

7.2 Cooperation in Capacity Building

- Strengthen the institutional capacity of Nepal Bureau of Standards and Metereology (NBSM) and the Department of Food Technology and Quality Control including that of the private sector, to ensure effective quality determination, certification and proper measurement standards.
- Extend support and strengthen the existing institutions engaged in entrepreneurial education and business incubations.
- Strengthen the institutional capacity of the Ministry of Industry (MOI) and that of the Ministry of Commerce and Supplies (MOCS) in policy formulation, formulation of PPP mechanism, planning and research in commensurate with the global and regional trend.
- Strengthen the capabilities of MOI and MOCS to compile, process and diffuse the necessary data on the investment climate and business opportunities.
- Strengthen the institutional capability to organise the Investment Forum on ‘Trade and Investment Opportunities in Nepal’.
- Strengthen the capacity of MOI and MOCS for bilateral, regional and multilateral talks and negotiations.

7.3 Cooperation in Creating Physical Infrastructure

- Help establish the ‘Data Bank’ to collect, process and disseminate information on the investment climate and business opportunities for informed decision-making for the benefit of both the public and private sectors.
- Help establish the Patent search centres at different locations within the country that has industrial clusters.
- Help establish more business incubators equipped with requisite physical infrastructure, including plant and machineries.
- Help establish a ‘model’ SEZ which can have a strong demonstration effect and is replicability by private sector.

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