

Reinvigorating Private Sector Development

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Presentation

- Importance of Private Sector
- Performance of manufacturing and trade
- Investment and Investment climate
 - Law and Order/ Security
 - Institutions
 - Infrastructures
 - Labor relations, productivity, and wages
 - Capital
 - Policies and politics
- Some recommendations

Importance of Private Sector (in gross capital formation)

	1989	1995	2008
Private Sector/ODA	1.7	4.1	8.1
Private/Public Sector	1.1	2.0	5.8

Share of Manufacturing is Declining

Sector/Year	1991	2000	2007	2008
Agriculture	46.5	37.8	32.5	32.6
Industry	19.4	23.8	16.6	16.0
Manufacturing	7.0	10.0	7.5	7.1
Services	34.1	38.4	50.9	51.4

Manufacturing Sector Growth

Sector/Year	1991-2000 (% change)	2001-2007 (% change)	2008
Manufacturing	9.4	3.0	0.18
Exports (import of capital goods)	25.8 (32%)	3.6 (28%)	-1.9

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Export Performance is Deteriorating, too

	1991-2000	2001-2006	2006-08
India	35.9	12.0	-2.5
Countries other than India	22.8	-4.3	7.9
Total Exports	25.8	3.6	0.5

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Law and Order/ Security

- Anarchy, violence and intimidation are some of the major problems for business communities
- Within last 8 months (since election April – November'08)
 - 20 entrepreneurs were killed,
 - 55 were kidnapped and offended and injured
 - 54 major industries were either closed permanently or closed for more than 62 days mainly due to labor problems
- Problems still continuing; increase in the phenomena of lawlessness and impunity
- Bandh Hadtal ; 120 days in 11 months and more in some areas

Institutions

World Bank –Doing Business 2009

- starting a business; dealing with construction permits;
- employing workers; registering property,
- getting credit; enforcing contract,
- protecting investors; paying taxes,
- trading across borders; closing business

Institutions

- **Enforcing contracts (rank) 121**
- Procedures (number) 39
- Time (days) 735
- Cost (% of claim) 26.8
- **Employing workers (rank) 150;**
- **Protecting investors (rank) 70**

Institutions

- Trading across borders rank—157
- Documents to export—9
- Documents to import—10
- Closing business (time; years)—5
- Recovery rate (24.5 cents per dollar)
- Paying tax (rank) 107
- Total tax rate 34.1% of profit

Institutions

- One window policy not effective
- Institutes to deal industry/trade weak

Institutions/ Investment Climate

- Nepal slipped to 121 rank in 2009 from 111 rank in 2008 (rankings on the ease of doing business)
- There has not been any reform/ improvement in the areas of investment climate (in the areas of 10 points mentioned above)

Inadequate Infrastructure

	Road Density (Km/000 Sq. Km)	Electricity Consumption (Kwh)
Nepal	89.9	62
LDCs	163.4	106
Developing Countries	700	1155

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Infrastructure (electricity)

- Supply 360 MW and demand about 800 MW in dry season; Gap 100% of present supply
- Electricity tariff has not been revised for 10 years
- No progress in incentives to start construction of hydro-projects
- Bringing from India also takes time

Labor relations

- Labor productivity is low (U\$ 1061/ per person in industry compared to U\$ 1602 in India and U\$ 4612 in China)
- Labor productivity, however in non-agriculture sector is about 5.5 times higher than the agriculture sector

Labor relations (2)

- But labor productivity in the non-agriculture sector has declined by 14% during the last decade (1995/96-2003/04)
- Annual wage increase (in current price) 12% in manufacturing and 9% in construction between 2005-2007
- Nepal is also suffering from “Dutch diseases” (increasing overseas employment opportunities, out-migration, increasing remittances but decline in productivity and inflexibility in hiring)
- These are serious problems for overall investment climate of the country

Labor relations (3)

- Labor unrest in the name of perks, benefits, and so on. Almost all big industries are affected
- In many cases, wage demand is in excess to the productivity growth
- Difficulty in flexibility in firing--firing related index in Nepal 70 (out of 100; higher the number more difficult is the situation)

Capital

- C/D ratio one of the highest in Nepal
- Liquidity problem
- 2009/10 can have liquidity problems (because of lower remittances)

Politics and Policies

- Maoist Government—should work harder than others to develop business confidence and investment climate
- Budget provided mixed signals for private investment (cooperatives, reversal of divestment programme, increased capital gain tax, income source requirements for investments)
- “A large group of Maoist leaders want more government/ central control in the economy” (AFP, Nov. 22, 2008: The Nation, Pakistan)-wrong political message

Politics and Policies

- Emphasis is too much on employment creation one time (construction activities; youth employment programme etc. can create jobs in the short run and many of these are one time activity and formed capital remains idle)
- No divestment programme
- Prospect for economic growth is bleak
- Support to viable sick industries in injecting new capital and carving out ailing situation (rescheduling borrowing)

Recommendations (Security)

- Security all over the country
- Actions for intimidators and stop to forced collection of money;
- enforcement of rule of law
- Industrial Security Force makes little sense
- Demand for armed private security could increase if the situation continues

Institutions

- Procedural Simplifications (reform mainly in the 10 areas identified for improving investment climate)
- Effective One Window (include utilities and make decisions binding; especially upgrading of the committee is important)
- Effective BOI (with permanent secretariat and legal and executive power)

Power shortage

- Immediate purchase agreement with India and war footing action plan for constructing transmission lines (in both sides of the border)
- Immediate PPA for hydroelectric projects (by increasing PPA rate; tariff needs to be increased in future not today)
- Cost sharing by public sector is also a possibility for IPP's investment

Power shortage

- Act to open up captive power operation/ PPA
- Existing thermal plants to be made fully operational
- Initiate the effective programme to reduce the present 25% leakages
- Initiate strong demand side management

Labor

- Annual wage should be negotiated on the basis of productivity
- Annual wage should be negotiated, not forced
- Wage increase, if it is substantial should be implemented over a period of time and not in a single year
- Greater use must be made of variable compensation systems such as bonus payments, profit sharing schemes, and productivity incentive schemes

Labor (1)

- On the job training programme should be initiated and strengthened
- Additional training programme for the laid off workers must be institutionalized
- Retirement benefits must be addressed by introducing contributory retirement-fund and similar kind of other schemes
- Flexibility in labor laws (No linkages with productivity; no difference between multinationals and small industries in terms of facilities to be provided)

Recommendations (capital)

- Unlock key credit market (high spread rate; low liquidity; low investment opportunities) –
- Lower cost of capital
 - Government needs to spend more (so that the money is circulated in the market)
 - Measures to cut interest rate and improve credit provision

Other Recommendations (Entrepreneurs)

- Reduce Cost of Production
- Exploitation of local comparative advantages with the help of local/central government
- Emphasis on Value Addition
- Introduction of New Technology and Productivity
- In service Training of Workers
- Reduction in other transaction costs

Recommendations (Policy)

- Growth oriented policy should be emphasized
- Ancillary Industries; Parts and Components should be emphasized (more incentives and better environment needed)
- New Package to SMEs (inst. Back up, credit, technology, linking with big companies. Diseconomies of scale, skill improvement, BDS etc.)
- Industrial Policy –should be seriously implemented

Recommendations (policy)

- Functioning of SEZ/ EPZ
- Training Package (Poly-technique/ trade schools to be geared towards need based training and upgrading; PPP)
- Focus on increasing the overall share of non-agriculture Sector in the economy (not only on revenue, but also in developing competitiveness and export promotion)

Conclusion

- End to imputing and lawlessness and Bandh
- Address institutional constraints (esp. 10 areas identified in Doing Business Report)
- Immediate action to power shortage problems (agreement with India and incentives to investors)
- Address to labor problems with the right to invest and investors

Conclusion

- Emphasis to growth (pro-poor/inclusive) oriented policy
- Mechanism to unlock credit market and addressing liquidity problem

Thank you for your
attention