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Foreign Affairs and Aid Sub-Committee**

Submission on

**“The role of the private sector in promoting  
economic growth and reducing poverty in the  
Indo-Pacific region”**

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**Submitted by:**

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(Implemented by UNDP and Government of Nepal- Ministry of Industry  
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## Executive Summary

After Nepal liberalized its economic policies following the democratic movement in 1990, the country has witnessed the growth of private sector businesses. Except for an interval between 1996-2006 when the ultra-left Maoist party waged an armed insurgency in the country, the government has been endeavouring to liberalize country's economy and to create private sector friendly policies and structures. There has been remarkable progress in service sector, particularly financial, hospitality, tourism, education and health. However, country's industrial development is dismal as compared to the countries which adopted liberalization at the same time neither could private sector flourish during this period. This can be attributed to a number of causes i.e. the lack of capacity, raw materials and investment; political instability and frequent change of government and the economic policies swinging between pro-liberals and anti-liberals i.e. communist parties; non-tariff barriers for export and inter-country movement of goods; frequent labour movements; frequent large scale strikes and highways blockades; etc.

Micro Enterprise Development Programme (MEDEP), a joint initiative of the government of Nepal and UNDP. This has been implemented since 1998 with an objective to reduce poverty through the development of micro entrepreneurs, targeting poor rural and socially excluded population. Over the last 15 years, MEDEP has created over 66,000 Entrepreneurs who have created over 70,000 sustainable jobs and three quarters of them have come out of poverty. Australian Aid is the major donor in its third phase and ongoing fourth phase. MEDEP's efforts has been to link these micro entrepreneurs with larger industries through a systematic sub-contracting. MEDEP is also facilitating for the export of micro entrepreneurs' products to neighbouring countries and further afar. MEDEP has supported the government to internalize this programme into government's own Micro Enterprise Development for Poverty Alleviation Programme and the major objective of MEDEP IV is to build the capacity of government to implement the programme. MEDEP will also capacitate private sector organizations to provide business development services to the micro entrepreneurs and to link their products to larger and distant markets.

Similarly, the government has also created many policies and structures to augment industrial development in the country. Thus, an environment for industrial development is gradually being created and there is a tremendous opportunity for Australian Government and other international development partners to invest in enterprise development and trade sector including all sizes of enterprises such as micro, small, medium and large as all of them have their own comparative advantages in Nepal. For example as the locally available resources (raw materials) are available in isolated, fragmented and small areas, micro-enterprises are feasible to operate. Larger industries can use the finished or semi-finished products of micro-enterprises through sub-contracting mechanism. This will help in poverty alleviation by creating employment in rural areas and in accelerating economic growth of the country by fostering small, medium and large enterprises creating win-win environment for all kinds of enterprises.

GoN has identified 19 products<sup>1</sup> which are exportable and are going to add some more which have comparative advantage. Donors and private sector supports are needed for expanding the export and reducing the trade deficit. Australian Government and other international development partners can provide both technical and financial supports in developing policies, acts and guidelines that facilitates in creating conducive environment for developing enterprises and promoting trade. Australian government can help expand the market of Nepali products in the pacific. Specifically, support is needed to establish pesticide residue testing laboratories and upgrade the capacity of the existing quarantines check posts in the borders of India and China so that the trade can be eased to and from Nepal.

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<sup>1</sup> Nepal Trade Integrated Strategy. Ministry of Commerce and Supplies. 2010.

## **Submission on “The role of the private sector in promoting economic growth and reducing poverty in the Indo-Pacific region”**

This submission is made by Micro Enterprise Development Programme (MEDEP), a joint poverty alleviation initiative of the Government of Nepal and UNDP and currently being financially supported by the Australian Aid. This paper briefly outlines the obstacles for private sector development in Nepal and potential sectors in which the Australian Government can support to accelerate country's economic growth.

### **The current role of the private sector in accelerating the pace of economic growth and in reducing poverty in Nepal:**

The role of the private sector in accelerating the pace of economic growth in Nepal started after the newly formed democratic government adopted liberalized economic policies in 1990. Earlier, the government itself operated major large industries in the country and patronized few business houses from the private sector. Over the last 25 years, the private sector has thrived in Nepal; the GDP has increased to US\$ 19.40 billion in 2013 from US\$ 3.6 billion in 1991; the dependence on agriculture for employment has come down to 74% in 2008 from 83% in 1991.

The unemployment rate of Nepal is 46% in 2012. The employment in Nepal is 54% with the contribution of private sector in only about 25%. For the reference, 70% of employment is from Agriculture sector. As per World Bank report – 2011, the private sector contributes 16.34% of GDP of Nepal. Agriculture remains Nepal's principal economic activity, employing 70% of the population and providing 37% of GDP. Agriculture in Nepal is mostly at the subsistence level. However, there is a vast potentiality to commercialise it through modernization and commercialization of comparative advantage products. Government of Nepal (GoN) is committed to promote private sector for national economic development. In this context, GoN has promulgated Industrial Policy 2010 with the purpose of facilitating investment by private sector in the industrial sector. For the first time GoN has given high priority in the policy to Micro-Enterprise Sector as the means of poverty alleviation targeting the Women, Poor and Excluded in rural areas and later linking them with small, medium and large enterprises for their scale up. GoN has also drafted the Industrial Enterprise Act and its By Laws that is in the process of approval by the newly formed parliament. Likewise, other several policies and acts are drafted and in the process of approval such as Special Economic Zones Act, Foreign Direct Investment Act, Investment Policy, Intellectual Property Act, revision in Company Act, Nepal Standard Act, National Trade Integrated Strategy, etc. Likewise, GoN has created several funds such as Micro, Cottage and Small Industry Fund, Women Entrepreneurs Development Fund and Technology Transfer Fund to provide direct support to Micro, Cottage and Small Enterprises (MSEs). All these initiatives taken by the government are for the purpose of creating conducive environment for economic development through enterprise development. In spite of having tremendous potentialities of enterprise development based on locally available resources (raw materials) from community forest, agriculture, mines, water, etc. the enterprise sector development in Nepal has been sluggish in the absence of low and mid level trained manpower

in the specialised area. Realising the fact GoN has established Council for Technical Education and Vocational Training (CTEVT) to produce such manpower needed in different enterprise sector. CTEVT runs several courses in about 21 Training Centres and more than 500 private training centres are affiliated to CTEVT that are running different vocational training course.

After adopting economic liberalization policy and entry into World Trade Organisation (WTO), a fast and significant development has been observed in financial service sector. Before adopting economic liberalization, GoN had only three government owned Banks but now about 247 financial institutions<sup>2</sup> such as Private Banks, Finance Companies, Micro-Finance Institutes, Financial NGOs (FINGOs) and Co-Operatives which are affiliated to the central Bank and operating financial transaction all over the country. Therefore, there is no dearth of access to finance opportunities for micro and small enterprises. However, still there are policy issues to be addressed to resolve the problems of easy access of credits by micro and small enterprises.

Apart from Government and donor agencies many NGOs and INGOs are also working in Nepal for the promotion of micro and small enterprises focusing to strengthen the private sector for employment creation and for economic growth of Nepal. In order to do so, I/N/GOs have focused on upgrading the occupational skills of the youth of Nepal based on curriculums of Council of Technical Education and Vocational Training (CTEVT) and others. About 3% women and men have been upgraded skills in last one decade. To accelerate private sector, the government has also adopted policies to provide facilities to the financial institutions in the rural areas and has created a number of initiatives to support such initiatives. Numerous of them are youth self-employment fund, Rural Self Reliance Fund, Fund for Women Entrepreneurs, etc. The government has formed Investment Board to facilitate the large scale projects in the country. Recent government efforts and policies have increasingly recognized the role of private sector for employment generation and to accelerate economic growth.

- **Current Australian Government support for private sector development through bilateral and multilateral investments.**

Through UNDP, Australian Aid has been supporting Micro-enterprise Development Programme (MEDEP) in Nepal which focuses on reducing poverty through entrepreneurship development. MEDEP have created more than 66,000 micro-entrepreneurs as of December 2013 in private-informal sector in order to create employment opportunity and poverty alleviation. Those entrepreneurs are rural poor people, most of them women and socially excluded groups and have created more than 200,000 sustainable jobs in the rural areas. According to a 2010 impact study of MEDEP, 73% of the households supported by MEDEP have come out of poverty and 80% of MEDEP entrepreneurs continue their businesses even if MEDEP supports are released. Also, on an average, a micro-entrepreneur earns more than twice the amount he/she earned before becoming part of MEDEP programme.

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<sup>2</sup> Report published by Nepal Rastra Bank on 4 May 2014.

Australian support in this area has been consistent and continuous since 2004 with a total commitment of about US \$ 46 million. UNDP and GoN have recently launched the 4th phase of MEDEP as a five-year programme (2013-2018) of US \$ 32 million with the substantial support from Australian Government.

The focus of the 4th phase is not only to lift the poor out of poverty, but also to build the institutional capacity of national stakeholders (the Government, service providers, micro-entrepreneurs' associations) to establish, implement and sustain a micro-enterprise development system.

The model that MEDEP developed and successfully implemented has been adopted by the Government of Nepal, which has launched a national programme called Micro Enterprise Development for Poverty Alleviation (MEDPA) based on this model. MEDEP phase IV will support the Government to build the necessary institutional capacity to implement MEDPA and make it sustainable. As the Micro Entrepreneurs grow and scale up into small and medium enterprises, they require further support in order to access remote markets at national and international level.

With the support of Australian Aid through UNDP about 628 Micro-Enterprises are graduated to Small Enterprises and are registered in the government concern agencies. These small enterprises have started paying tax to the government. In phase IV (August 2013 to July 2014) MEDEP's primary role will be to develop the capacity of Government and concern stakeholders to replicate MEDEP by government in the name of Micro-Enterprise Development for Poverty Alleviation (MEDPA) and also providing to micro-entrepreneurs more scaling up supports to make them resilient and graduate to small enterprises and it has been estimated that about one percent of total entrepreneurs (new and existing) will graduate every year and by the end of phase IV about 4,000 micro-enterprises will graduate to small enterprises. This means the products and services of these small enterprises will meet the economy of scale for supplying their products and services to the national and international markets. This needs a significant amount of energy of MEDEP IV in playing role of developing business to business (B2B) linkages among micro, small, medium and large enterprises. At present there are about 32,326 small manufacturing establishments in Nepal employing about 67,376 persons directly and 122,200 persons engaged in the establishments and their annual output is NRs. 41,489,517,000 (US \$ 432 million approximately)<sup>3</sup>. MEDEP is already working on developing backward and forward linkages among micro, small, medium and large enterprises such as honey business with Gandaki Bee Concern, Organic Honey business with Organic Certification of Nepal, Milk and Milk Products with Nepal Dairy, Allo<sup>4</sup> Yarns produced by micro-entrepreneurs in rural areas

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<sup>3</sup> Survey of Small Manufacturing Establishments in Nepal (2008/09). Central Bureau of Statistics, National Planning Commission, Government of Nepal.

<sup>4</sup> Himalayan Giant Nettle (*Girardinia diversifolia*) wildly grown in the mid and high hills of Nepal in an altitude between 1,200 to 3,000 metre above mean sea level. MEDEP 2013. Micro-Entrepreneurs' Products Portfolio.

supplied to Carpet Industries in Kathmandu which is exported to other countries, strawberry and Off-Season Vegetables exported to India through traders, Ginger and Ginger based products exported to India, etc. So far MEDEP promoted entrepreneurs have earned net profit of approximately NRs. 7 billion (US \$ 72.9 million). This indicates that collectively their transaction has significantly contributed to Nepalese trade and this value will increase by manifolds when about 4,000 micro-enterprises will graduate to small enterprises requiring MEDEP estimated figure shows that in the last six months micro-entrepreneurs were able to export different products such as Allo Yarn and Products, Dhaka (hand woven handicrafts) products, Chyuri (Aesandra butyracea) Herbal Soap, Nepali Paper Products, Thanka Painting, Bamboo Products, Honey, Ginger, etc. worth NRs. **472,270,330 (US \$ 4.91 million approximately).**

In addition to MEDEP, Australian Aid is funding two regional Projects targeting the South Asian region namely "Trade and Transport Facilitation Audit in South Asia" and "Promoting Micro, Small and Medium Enterprises (MSMEs) for Inclusive, Equitable and Sustainable Development in South Asia". The first one is implemented by South Asia Watch on Trade, Economics and Environment (SAWTEE) and the latter by UNDP Asia Pacific Regional Centre (APRC).

- **Legislative, institutional, social and policy constraints that may reduce the ability of private sector agencies to engage in development.**

Nepal is currently governed by an interim constitution of 2008 (BS2065). As the writing of new constitution by elected Constituent Assembly (CA) is delayed, it has become difficult to give momentum to any economic reform agenda. The period is marked by political instability and constitution writing has overshadowed all other agenda. Besides, with MEDEP support, the draft Industrial Enterprise Act has been finalized but is not prioritized by the CA which also works as the legislative parliament. The draft act recognizes Micro Enterprise sector and has provisions for Micro Entrepreneurs' access to various facilities. Structures in the government (Ministries of Industry, Commerce, etc.) and private sector (Federations of the Private Sector Organizations) have been established and need to be oriented on how to increase domestic production and internationally advocate for the rights of the land-locked countries.

- **Additional partnerships, activities or financial instruments the Australian government could use to enhance the role of the private sector in development in the Indo-Pacific region.**

In order to help Micro and Small Entrepreneurs grow and to increase their collaboration with Medium and Large Entrepreneurs, Nepal needs sub-contracting guidelines. In many countries Sub-Contracting Act or Guidelines exists that facilitates sub-contracting of micro and small enterprises products and services to medium and large enterprises. These instruments should facilitate systematic sub-contracting to enable big industries procure

semi-finished/raw materials from small enterprises and the latter will have assurance of market for their products. Thus, all levels of industries will grow and country's economic growth will take momentum. MEDEP has been providing technical support to the GoN to formulate such guidelines and has been incorporated as a part of proposed Industrial Enterprise Act.

MEDEP's collaboration with the organizations of private sector like Federation of Nepali Chamber of Commerce and Industries, National Micro Entrepreneurs Federation and Federation of Nepali Cottage and Small Industries can be leveraged to push private sector in the country. In the future, this collaboration should be strengthened to facilitate the export of Micro Entrepreneurs' products. Australian support would be instrumental to establish the formal linkages between Nepal and other countries in the Indo-pacific region.

- **The role of public-private partnerships in leveraging private sector investment in developing countries.**

Nepal is one of the poorest countries in the world, but the demand for infrastructure and capital investment is enormously high. 143 out of 144, second last from 144 countries surveyed, this is the rank of Nepal in Infrastructure as given by the Global Competitiveness Report 2012-2013 produced by the World Economic forum. Therefore, Government of Nepal (GON) has given high priority on PPPs for infrastructure development in all sectors, for instance road, transport, energy, communication, agriculture, tourism industry, production industries, etc. In order to strengthen and sustain the PPPs strategy and lure investment in Nepal, Government established 'Investment Board Nepal' in November, 2011 as a one window solution for foreign investors.

International Finance Corporation (IFC), a member of the World Bank Group, is the largest global development institution focused exclusively on the private sector is helping GON in institutionalizing and capacity building for PPPs to achieve sustainable growth by financing investment, mobilizing capital in international financial markets, and providing advisory services to businesses and governments.

In FY12, the FDI reached an all-time high of more than NRs 26 billion FY2013, up from just NRs.7.1 billion in FY 2012, leveraging the power of the private sector to create jobs, spark innovation, and tackle the world's most pressing development challenges.

Foreign investors have shown interest to GON for investment worth the value greater than investment made in last 20 years in Nepal just in 10 months of running FY. More than four thousand foreign investors from 79 countries have shown interest to invest worth NRs.195 billion till date through 2817 industries. According to Ministry of Industry (MoI), investors have shown commitments for investment worth NRs 100 billion within 8 months of the current FY and if it turns into implementation it will provide employment opportunities to eight thought youth in Nepal.



The interest of FDI is in up-scaling order. India is the biggest investors among all and has shown commitment for investment worth NRs126 billion through 581 industries. As per the Ministry of Foreign Affairs of Nepal, Australian investment in Nepal up to 2011 totals US\$ 40 million only.

MEDEP is also a model of such collaboration between the government and the private sector. The Government of Nepal (GoN) has recently internalized MEDEP model into their own programme as Micro Enterprise Development for Poverty Alleviation (MEDPA) and implementing across Nepal's all 75 districts. This programme also follows PPP model in the sense that the government is taking lead in resource mobilization and programme assurance and the field level implementation is entrusted to the private sector. MEDEP has also developed an Eco-Tourism Trail in Parbat and Myagdi districts as a model of rural poverty alleviation through tourism.

There is large potential of numerous smaller projects for poverty alleviation and enterprise development under PPPs so that the private sector (formal and informal) is capacitated to implement large projects and the government garners experience and confidence to implement such projects.

- **Risks related to current and possible future approaches to enhancing the role of the private sector in development, and their management.**

Public-Private Partnerships (PPPs) is an innovative option used for delivering a public service. It is basically a contractual agreement between a public entity and a private entity, whereby the private entity performs part of a government organization's service delivery functions, and assumes the associated risks for a specified period of time. In return, the private entity receives a benefit/financial remuneration according to predefined performance criteria. The government enters into PPPs to attract private capital investment; to increase efficiency and use available resources more effectively; and to reform sectors through reallocation of roles, incentives, and accountability.

The Government of Nepal has recognized PPPs as an important approach for development but country has not been able to implement PPP infrastructure project in a substantial way. Lack of clear-cut vision, political transitions, unstable government and social transformations have been the current and future constraints for the PPP approaches to be executed. The constitution writing process is still in-process since 2008 through CA1 and CA2 and yet not taken pace to accomplish the most awaited document for general public of the nation and business sectors. The private sectors are still not confident for investment because of only political transition and instability and they are in strategy to 'wait and watch' only.

The lack of political commitments and political stability have led to non-conducive environment for investment in large scale industries. Although Nepal is rich in hydro

resources for generating hydropower yet there is insufficient power generation required both for running enterprises and household purposes and therefore, there is long period load shedding and enterprises are not operating in full time. This has reduced their efficiency of production. However, GoN has planned to overcome load shedding in the next three years as many hydropower projects under construction will be complete by then.

The conflict between the enterprise owner and labourers is another factor discouraging private investment in the country. However, such obstructions have gradually reduced over the last three years and the industrialists pinning hopes that such environment will continue so that they can invest more money in Nepal.

There are high demands of food products such as Honey, ginger, Coffee, Medicinal Herbs and Herbal Products in the international markets. However, due to lack of accredited residue testing laboratory in Nepal the trade could not be expanded as per demand. The Quarantine facilities in the check posts both between Nepal and India and Nepal and China are not adequate and therefore most of the trade with India and China is conducted through informal channel. There is larger need to modernize and capacitate such check points.

- **The role Australian and international businesses could play to support development and inclusive growth in partner countries.**

The BoP situation has been disappointing since many decades and the country had recorded a BoP surplus of Rs 127 billion in current fiscal year. According to Nepal Rastra Bank (NRB), the imports of merchandise and services have increased significantly compared to last year. The country's trade deficit has increased by 25.% to Rs 309.5 billion. Exports have declined by 14.1% this year.

The Australian and International businesses have high potential to work in Nepali market to promote businesses of the goods of comparative advantage for following reasons:

- i. Abundance of natural resources.
- ii. Rich in human resources; every year 450,000 youth enter into the labour market and Nepal is second largest market of the world for exporting labour.
- iii. The labour cost is very cheap with respect to other poor and developing countries.
- iv. GoN has given high priority to open economic policy and FDI.
- v. High potential to bridging formal and informal labour and market for low cost and high quality production through entrepreneurship and skill development projects to support development and inclusive growth in Nepal.
- vi. Investment climate –there are many commercial banks are available to finance sustainable business
- vii. Infrastructure: Nepal is implementing few large scale infrastructure projects like mid-hill highway, east-west railway links, Hetauda-Kathmandu tunnel road, three

- international airports etc. Once these projects are completed over the next few years, Nepal will have greater and faster connectivity and mobility of goods and the people. This will give impetus to the development of private sector businesses in the country.
- viii. ICT – Information and communication technologies which are the tools of enterprise development are developing in faster rate in Nepal. Almost every district has telephone connectivity, three quarters of the population has mobile phones and one third of the population has internet access. This sector can itself be developed as an enterprise while it can also be utilized to aid other businesses.
  - ix. Nepal is located in the strategic place between two big countries India and China which are making giant strides in terms of development. Nepal could be trading hubs for trade promotions and strengthening the business linkages

To sum up, environment for industrial development of the country is gradually being created. There is a tremendous opportunity for Australian Government and other international development partners to invest in enterprise development and trade sector including all sizes of enterprises such as micro, small, medium and large as all of them have their own comparative advantages in Nepal. For example as the locally available resources (raw materials) are available in isolated, fragmented and small areas micro-enterprises are feasible to operate a good example established by MEDEP generating employment to a large number of unemployed people. Larger industries can use the finished or semi-finished products of micro-enterprises through sub-contracting mechanism. This will help in poverty alleviation by creating employment in rural areas and in accelerating economic growth of the country by fostering small, medium and large enterprises creating win-win environment for all kinds of enterprises.

GoN has identified 19 products<sup>5</sup> which are exportable and are going to add some more which have comparative advantage. Donors and private sector supports are needed for expanding the export and reducing the trade deficit. Australian Government and other international development partners can provide both technical and financial supports in developing policies, acts and guidelines that facilitates in creating conducive environment for developing enterprises and promoting trade. For example there is a need of sub-contracting policy and guidelines for creating a win-win environment for all kinds of enterprises particularly required for promoting and making sustainable the micro-enterprises. Supports are needed to establish pesticide residue testing laboratories and upgrade the capacity of the existing quarantines check posts in the borders of India and China.

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<sup>5</sup> Nepal Trade Integrated Strategy. Ministry of Commerce and Supplies. 2010.