

A Review of Trade and Industrial Policy in Nepal

Introduction

The role of the government in the economy has been a major source of debate in development thinking. In the early 1990s, under the Washington Consensus, the International Monetary Fund (IMF) and the World Bank sought to liberalise the economy. The market was identified as an efficient mechanism for resource allocation, and the role of the government in the economy was minimised. However, by the mid 1990s, it was clear that market forces, on their own, are not sufficient for development.



A new paradigm known as the post-Washington Consensus is now at the forefront of development thinking. The post-Washington Consensus while recognising the critical role of market forces and private entrepreneurship, advocates for the government to perform strategic and coordinating role in the economy to reinforce or counteract the allocative effects of market forces.

Economic policymaking and the level of government intervention in Nepal has closely followed the international trend of the time. Until the mid-1980s, Nepal followed an active industrial policy with direct involvement of the government in the economy. In the

mid-1980s Nepal initiated economic liberalisation through the implementation of Structural Adjustment Programmes (SAPs). The government withdrew and the private sector took the lead role in the economy.

This Research Brief will give a brief overview of the policies adopted by the Nepali government to promote industrial development and economic growth. The second part of the research brief will explore policy initiatives of the government in specific sectors, previously identified as export potential.

Industrial Policy

Nepal's industrial policy can be roughly divided into two time-periods, pre-1985 and post-1985. Before 1985 policies were guided by inward looking protectionist strategies. Domestic industries were treated as 'infant industries' and were protected from foreign competition by high tariff and quota restrictions. The government was directly involved in the economy and provided essential products and services.

Liberalisation initiated in 1985 and accelerated after the 1990s, sought to modernise the economy and accelerate structural changes by creating an environment appropriate for private sector participation. The government began to withdraw from the economy, and policies were implemented to promote private and foreign investment.

A new liberal Industrial Policy was formulated in 1992. One of the major objective of the Industrial Policy of 1992 is to privatise public sector industries. The policy seeks to create an open and competitive economy by curtailing government interference in price fixing of industrial goods. In addition, the policy aims to strengthen linkages between manufacturing and agriculture sectors and promote labour intensive, local resource based, export oriented industries. Private sector participation is also encouraged in community and private forest development, generation and distribution of hydro-electricity and in construction and management of nursing home, hospital, power propelled railway, roads, bridges, tunnels, ropeways etc.

Investment Policy

The Industrial Policy of 1992 identifies foreign investment promotion as an important strategy to achieve increasing industrial production, meeting the basic needs of the people, creating employment opportunities, and paving the way for improvement in the balance of payments situation. To promote investment the current Industrial Policy consists of the following components: the Industrial Enterprises Act; the Foreign Investment and Technology Transfer Act, and the One Window Policy. The major thrust of these acts and policies lie in their emphasis on market-driven strategies, and the dominant role of private enterprises.

Trade Policy

Until the mid-1960s, Nepal's trade did not extend beyond India in the South and Tibet in the North. To expand trade Nepal adopted export diversification and import substitution strategy during the third five year plan (1965-70). This two pronged strategy was meant to narrow down the trade deficit, promote industrialisation and help diversify the economy. Other policy measures adopted by the government to promote exports include: the Dual Exchange Rate System of 1977, cash subsidy programme, duty exemption on export commodities, special financial arrangement for production and export, simplification of licensing and customs procedures, and introduction of new industry and trade related acts etc.

In 1992 a new liberal Trade Policy was introduced to support the economic liberalisation programme. The major objectives of the Trade Policy 1992 are to promote internal and international trade, encourage private sector participation, diversify trade in terms of both commodity and destination, promote backward linkages, expand employment oriented trade and reduce trade imbalances.

Nepal's export policy seeks to raise production and quality of exportable products and make them globally competitive. The policy emphasises the need to export high value added products and recognises the need to identify new markets and products. In addition, the policy adopts a range of strategies to promote exports such as: removal of license (with some exception), exemption of duty on imported raw materials, exemption of income tax on income from exports, introduction of container service and expansion of bonded warehouse etc.

An Assessment of the Trade and Industrial Environment in Nepal

The purpose of industrial policy is to attain economic growth by providing investors with incentives to engage in productive growth. An in depth review of

Nepal's industrial policy and environment suggests that the government has been able to attain macroeconomic stability in terms of inflation, interest rates and exchange rate. However, Nepal's industrial policy seems unable to provide incentives for both domestic and foreign investment.

Despite policy initiatives to attract investment, the flow of Foreign Direct Investment (FDI) to Nepal is very low. Investment is limited to products that require low-technology and most foreign investors of Nepal are individuals rather than corporations. In terms of trade, despite efforts to promote exports and reduce the trade deficit, the trade deficit has been widening over the years, and Nepal's export is still concentrated in a few products and destinations. Dependence on a narrow export base not only makes export led growth harder but also makes the economy susceptible to global economic volatility.

In this context an active industrial policy to promote structural change of the economy is desirable. The World Trade Organisation (WTO) provides flexibility to LDCs like Nepal to adopt Trade Related Investment Measures (TRIMS) to provide incentives to industries. The government should therefore take the lead and target and promote industrial development by balancing regulations with incentives. The first step would be to update the industrial policy to make it relevant to the current environment. The government should also focus on co-ordinated learning and sharing with the private sector to understand the constraints and potentials of different sectors of the economy, and formulate sound policies.

Sector Specific Policies

SAWTEE and ActionAid Nepal recently conducted a research study to identify goods and services with comparative advantage. The study selected three items (tea, herbs and leather) from the goods sector and two sub-sectors from the services sector (tourism and information and communication technology-ICT). The next section of the research brief will explore government policies and initiatives to promote the sectors and products.

Tea

Realising the potential of tea, the government has formulated policies to promote private investment in the sector. In 1982, the government declared five districts in Eastern Nepal 'Tea Zones', which led to the first major push to expand the industry. An important policy for the development of the tea sector has been privatisation of the state-owned Nepal Tea Development Corporation (NTDC). During the Ninth Plan (1992-1997), NTDC ceased operations and its assets were leased to private companies.

The government's commitment to develop the tea sector was further reinforced by the introduction of the Tea Policy in 2000. The policy seeks to develop tea as a reliable source of income, enhance employment opportunities and foreign currency earnings by increasing the production of tea qualitatively and quantitatively.

Despite government efforts to promote the sector, tea cultivation still faces various policy constraints. An important constraint is the unavailability of cultivable land. Under the Eight Plan, exemption of land ceiling in the Eastern hill region for tea production was planned but it has not been implemented as yet. The land-ceiling is too low to derive economies of scale and the process to obtain extra land is difficult and requires approval of the cabinet. For a country with high level of political instability, such bureaucratic hassles should be simplified.

Herbs

Nepal's forest related policies and regulations seek to create economic incentives for the local people to conserve the forest while safeguarding their traditional livelihood options. Various laws and regulations govern the production, processing and exports of herbs. One of the important policies is the Master Plan for the Forestry Sector



(MPFS) of 1989. The 25 year policy and planning framework seeks to manage forest for income and employment opportunities through people's participation in the development, management and conservation of forest resources. While community forestry is the main focus of the plan, the plan also encourages foreign investment and recommends privatisation of government owned enterprises. The MPFS also spells out specific plans for the development of medicinal and aromatic plants (MAPs). Cultivating many of the wildly collected medicinal plants and processing them into value-added commodities are important policies under the plan.

However, the herbs sector is hindered by gaps, inconsistencies and contradictions under the set of laws and regulations that often cause user groups to confuse over property rights. In addition, lack of knowledge about legal provisions, market information, institutional support, production management and post-harvest operation forbid user groups from equitable benefit sharing of forest resources. A mechanism should thus be es-

tablished that formally involves all legitimate stakeholders such as collectors, traders, forest user groups in the policy development and revision process.

Leather

Despite Nepal's trade potential in leather and leather products, the government has neither formulated a policy framework nor implemented any specific programmes to promote the sector.

The leather sector is hindered by a range of constraints that include sluggish growth of livestock population and inability to export higher value added finished leather and leather products. Targeted programmes in partnership with the private sector are necessary to promote the sector. In addition, livestock development should be given priority and directly linked to the development of the leather sector.

Tourism

The potential of tourism in Nepal was realised as early as the First Plan (1955-60). Since then the government has formulated and implemented various plans and policies for the promotion of the sector. The ten year master plan that was prepared during the Fourth Plan is one of the most important

steps taken for the development of the sector. Under the plan a number of airports and airstrips were constructed, and credit was extended to the private sector for the construction of hotels. In addition, the government became aware of the need to conserve wild life and national parks to promote tourism.

In 1995 the government formulated a Tourism Policy to promote the sector. The Policy seeks to diversify tourism to rural areas and establish linkages between the tourism sector and agro-based cottage industries. The policy stresses the role of the private sector for the development and diversification of tourism products and promotes foreign investment including joint ventures in areas where there is scope for transfer of skills and technology.

To promote private sector involvement in the sector, the Tourism Department was dissolved and Nepal Tourism Board was established in close cooperation with the private sector. The board is responsible for

tourism product and resource development and seeks to promote tourism while conserving the environment.

The current development plan, the Tenth Plan emphasises rural and eco-tourism. The Plan encourages tourism model villages and intends to take measure for environment protection through pollution monitoring, garbage management and alternative energy programmes. Most importantly the Tenth Plan recognises the importance of intra-regional tourism and seeks to develop a sub-regional tourism plan in cooperation with other South Asian countries.

Since tourism is a rapidly changing sector, to promote the sector and extract maximum benefits, it is mandatory to keep abreast with the changing market. However, the Tourism Policy was last formulated more than a decade ago in 1995. It is thus important to revise the Tourism Policy and formulate and update policies to suit the changing international market.

ICT

Realising the importance of Information and Communications Technology (ICT) for growth and development of the society, the government has formulated various plans and policies to promote ICT. Under the Tenth Plan the government seeks to create a conducive environment to attract both foreign and private investment in the ICT sector. In addition, the government seeks to make IT accessible to the general public through education and training.

An IT Policy was formulated in 2000 and revised in 2004. Realising the potential of Nepal in ICT exports, the IT policy adopts specific programmes to encourage IT exports such as: adoption of one window system, development of IT park in different parts of the



country, provision of tax holiday for IT companies, removal of duty on exports of software products etc.

Despite the potential of ICT exports, the software industry of Nepal is not treated as a regular industry. It does not enjoy benefits that are applicable to other export oriented industries. The government should thus promote the software industry through tax incentives and subsidies beyond those applicable to a regular export industry. ■

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Launched in December 1994 at Nagarkot, Nepal by a consortium of South Asian NGOs, South Asia Watch on Trade, Economics & Environment (SAWTEE) is a regional network that operates through its secretariat in Kathmandu and 11 member institutions from five South Asian countries, namely Bangladesh, India, Nepal, Pakistan and Sri Lanka. Registered in Kathmandu in 1999, the overall objective of SAWTEE is to build the capacity of concerned stakeholders in South Asia in the context of liberalisation and globalisation.



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