Accelerating Private Sector Reform

ASIA’S PATH FORWARD
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CONTEXT

**Private Sector in Nepal:** Following the restoration of peace and the establishment of liberal economic policies in the 1990s, there have been years of sustained private sector expansion in the country. The Nepali private sector contributed about 80% of the economy’s gross fixed capital formation since 2001, equivalent to about 17% of the country’s Gross Domestic Product (GDP).\(^1\) As of 2019, the gross fixed capital formation contribution of the private sector has increased to 26.85% of GDP.\(^2\) The private sector is mostly dominated by small and medium scale enterprises: more than 90 of registered businesses are SMEs, and they accounted for about 22% of GDP in FY 2012/13.\(^3\) Thus, while most of the private sector still functions in the informal domain, it creates the highest number of jobs and encompasses many people engaged in employment or entrepreneurship. A policy shift toward privatization in the 1990s reduced the size of the public enterprise sector to levels below the South Asian average, and concentrated it in just a few sectors, such as utilities. More than 99% of formal firms are privately owned.\(^4\) With the exception of a few large, influential business groups, most firms are small. A few large, mostly family-owned, businesses continue to be significant players in traditional sectors. These business groups have survived Nepal's political ups and downs by diversifying, and by demonstrating an ability to navigate regulatory hurdles. Apart from these large firms, most other firms are small: only 18% of Nepal's formal firms have more than 20 employees.\(^5\)


granted monopoly by law to dominate the policy formulation discourse. As expected, these business associations advanced their narrow interests, and, without any equally influential countervailing interest GON policies remained largely protectionist. These private sector associations function as the agenda setter and influencer in policy analysis and take on the mandatory position as a member in the policy drafting committees. In addition, they utilize their position as negotiators on behalf of the private sector to lobby for their vested interests. The dysfunction and weak governance of the GON policy process manifested fully, when, despite an abundance of talk about liberalization, the final Foreign Investment and Technology Transfer Act (FITTA) included stronger protectionist provisions, as some industries (e.g., dairy) remained prohibited to foreign investors while the minimum capital requirement for FDI increased ten-fold to half a million dollars.⁶

**Corruption and Private Sector:** The pandemic further exposed the close ties of private businesses with the government and as corruption cases emerged, it illustrated the extent of government collusion with businesses. For instance, Omni Business Corporate International became a household name as each of the procurement scandals during the pandemic got linked to this company. The Public Account Committee of the House of Representatives has decided to summon Minister for Health, Bhanubhakta Dhakal, after recording statements from officials involved in a controversial deal to procure Covid-19-related medical goods and equipment through Omni Business Corporate International.⁷

The private sector bodies worked with the government to ensure that in mid-May, the Council of Ministers approved of a criterion regarding the vehicular movement pass for industries. To obtain the pass, industries must be registered and have their taxes cleared and must be recommended by the FNCCI and the NCC. For organizations not registered with these political associations, it was impossible to get passes for vehicular movement. Many people complained of the need to grease palms of officials at these institutions to get these passes. Thus, rather than finding strategic and holistic ways to engage with the government on recovery, Nepali private sector bodies were happy to find small opportunities of demonstrating their importance.

⁶ Nepal Private Sector Engagement Assessment, 2020
Private Sector Busy with Politics: The private sector organizations, especially FNCCI, were busy with the upcoming elections. The elections for national private sector bodies in Nepal have become very important as the key position in this organization gives one a direct seat to government regulatory bodies such as the Investment Board, Securities Exchange Board and other government organizations. This provides opportunities to get access to critical business information on other competitors and planned businesses. At the same time, government officials also find it easier to work with these business leaders when it comes to settling tax disputes or other matters where there is opportunity to make money.

LOOKING FOR SILVER LINING

Financial restrictions imposed by the pandemic have undoubtedly weakened the entire economy, resulting in a bear market. This has changed consumer behavior and decreased spending. Meanwhile, the government is also tackling important national-level fiscal problems. Thus, although COVID-19 has shaken up Nepal’s growing economy and daily life, the emergence of the new e-commerce companies is a silver lining to look forward to. All of these factors have created a hostile environment for emergent e-commerce companies.

Along the same lines, the Department of Commerce, Supply and Consumer Protection has prepared a draft E-commerce Bill 2020 which aims to create a facilitative regulatory environment for online trade in Nepal. This proposed law is expected to regulate and facilitate the trade of goods, services and intellectual property using electronic means. Additionally, it will support the growing digital ecosystem, which is most needed now as the e-commerce business has the potential to connect Nepali micro, small and medium enterprises, rural women and youth entrepreneurs, traders as well as exporters with global value chains and global e-commerce sales, which have grown from NPR 156 billion (USD 1.5 billion) to NPR 492 billion (USD 4 billion) between 2014 and 2020.

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LESSONS FROM DIFFERENT PARTS OF THE WORLD

There was encouraging news from other parts of the world from which, perhaps, Nepal could have learnt. Private laboratories in Germany helped test more than 50,000 people for coronavirus every day. Their widespread testing has enabled better tracking of the coronavirus's spread in their country in comparison to many other European nations. Across the country, testing for the coronavirus is free at the point of use for patients, whether they are covered by statutory or private insurance. Germany adopted digital health very efficiently as a fast-track means to monitor patients without the need of social interaction. To find innovative solutions to tackle the crisis, the German government commendably organized a dedicated hackathon, inviting private companies and startups into the collective battle against the virus.

In Vietnam, factories shifted their focus to manufacturing medical supplies, helping the health system avoid shortages of personal protective equipment and ventilators. Hundreds of bags of rice were brought by people and private organizations everywhere to support the “rice ATM” machine in Tan Phu District to those in need in Covid-19.

Similarly, in Rwanda, autonomous drones designed by a California based company called Zipline were able to deliver medical products across countries. This has expedited the testing process.

ROAD TO RECOVERY

Nepal needs to learn from other countries on how to move towards recovery. There are many lessons that can be adapted. For instance, the role of the government in Singapore is laudable and Nepal can learn how to adapt some of these to local conditions. The Monetary Authority of Singapore (MAS) designed a package of measures to help individuals and SMEs facing temporary cash flow difficulties, to help individuals meet their loan and insurance commitments and support SMEs with continued access to bank credit and insurance cover. It announced the establishment of a USD $60 billion swap facility with the US Federal Reserve to provide USD liquidity to Singapore banks through weekly auctions held every Monday. Further, MAS announced a USD $125 million support package to sustain and strengthen financial services and FinTech capabilities.

During the pandemic, Rwanda announced its ambitions to establish itself as a financial hub by 2024, asset out in the National Strategy for Transformation (NSTI). Work to establish the Kigali International Finance Center kicked off in early 2020. Rwanda Finance Limited- a government-owned company- is spearheading the establishment of an international finance center to introduce reform within the Rwandan financial services sector. The reform has three main pillars: laws and regulations within financial services sector, the tax policy, and skills and capacity development. It is modelled on
Luxembourg and Singapore in the way it will provide a wide range of services for both regional and international clients.

Learning from these countries, Nepali businesses should tap into their innovative and essential ways of coping with the COVID-19 in order to operate the economy much more effectively than it is being done at present.

**WHAT NEEDS TO BE DONE**

Managing Recovery through COVID-19 recovery funds

The objective of the Fund will be to intervene in conjunction with government economic relief programs to provide recovery in short to medium term and growth in the long term. The fund will be a key tool for private sector recovery and growth-oriented development in the future.

The underlying objectives will remain ensuring job loss does not occur, and more jobs are created in line with the targets of the Rwanda Vision documents.

The Fund will also use the opportunity to address key issues like promoting equity by intervening in rural areas and districts that have been lagging behind national averages.

The different sub-vehicles will be designed to meet the different segments. For example, there could be three vehicles. First, there will be one growth fund to drive some large companies and new businesses that will kick in a year which will ensure the Fund can earn the returns. Second, a MSME recovery fund with some impact component and third, a purely support fund with a combination of investment and impact.

Pushing Reforms

As we move into the next phases of the recession and subsequent recovery, reforms should aim at providing out-of-work workers with income and consumption support, while also encouraging a return to work as it becomes safer. The shock to the economy will be in a “stop-start” form and there will also be a substantial “reallocation shock” as businesses face persistently lower demand. For this reason, as the economy reopens, providing benefits directly to individuals or households through unemployment will lead to quicker relief via economic flexibility. The toll of COVID-19 has been especially acute for small and mid-sized businesses. Macroeconomic weakness will continue to suppress consumer spending and constrain small business lending. Government should provide support to SMEs that could be solvent in the post-pandemic economy, but that need new capital to sustain or reopen operations.
One policy that could be low-hanging fruit is short-time work, sometimes called a work-sharing program. The details of short-time work generally aim to preserve the employer-employee relationship during temporary output disruption by allowing employers to reduce worker hours even as the government subsidizes workers’ lost wages. This enables businesses to preserve institutional knowledge and avoid the lengthy and costly hiring and training process. The Nepali labor laws need to accommodate these.

**Small Incremental Steps**

The Monetary Policy for the FY 2020/21, which has targeted an annual economic growth rate of 7%, aims to address the economic effects of COVID-19 and provide relief to various sectors affected by the pandemic. The policy has extended the loan repayment period for business enterprises, set a loan moratorium on principal and interest payments, provided refinancing facilities to increase access to subsidized loans and so on. By inculcating these positive policies and prioritizing cottage and small industries for the first time in the history of Nepali monetary policy, the needs of the business community have been addressed to some extent.

This shows that no big-bang efforts are required where there could instead be small incremental steps like opening up FDI, facilitating technology transfer, helping Nepali companies to invest outside that is still restricted by law. Similar other small steps can also get the momentum going. For this to happen, institutions like CIPE can act as a catalyst for discourse, bringing in international perspectives and learning.
This Asia’s Path Forward paper addresses Chamber and Association Responses and Strategies. Visit CIPE.org for further Asia’s Path Forward papers on the six essential themes for an economic recovery roadmap:

- Restarting Economies
- Diversifying Supply Chains
- Combating Corruption
- Authoritarianism and Challenges to Democracies
- Economic Challenges for Women and Marginalized Groups
- Chamber and Association Responses and Strategies

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