The Economic Journal on Nepal, Vol. 25, No.3, July-September, 2002 (Issue No. 99) © DOE-TU

Dynamics of Privatization in Nepal

*Kanhaiya B. Mathema**
*Bamdev Sigdel***

Abstract

The main thrust of this paper is to discuss the dynamics of privatization in Nepal. Drawing the conceptual background on economics of privatization, it examines the factors which were responsible for privatization drive in different countries. Further, it reviews the early industrialization drive, emergence of SOEs and the privatization process discussing the rationale for privatization in Nepal. The outcomes of privatization in Nepal have been analyzed at macro level.

1. Introduction

Privatization has become a central feature of the economic policies in many countries in the present era irrespective of their political systems. Broadly defined, privatization implies denationalization or selling-off of state-owned assets, deregulation (liberalization), competitive tendering together with the introduction of private ownership and market arrangements in the economic functioning of the nations. (Hartley, and Parker, 1991:11). More specifically, it is the transfer of majority of ownership of state-owned enterprises to private sector by the satc following liquidation (Kikeri, et al., 1994:24).

General consumers are expected to benefit from privatization through the introduction or extension of market forces reflected in the profit motives, rivalry, more choice, greater efficiency and innovation. The privatization policy has been associated with a desire for wider share private ownership and creation of a share-owning democracy (Hartlery, and Darver, 1991:12). The underling intent of privatization is to improve industry performance by increasing the role of market forces (Beesley, et al., 1996:30). In a broader sense, privatization is deployment of an arry of actions geared to expose the scope of private sector activity (Cavendish and Misty: 1992).

* Dr. Mathema is Associate Professor of Economics, Central Department of Economics, T.U., Kirtipur.

** Dr. Sigdel is Deputy Director in Special Studies Division/Research Section, NRB.

2 Global Scenario

Most of the developing economies around the world have introduced privatization in their economic systems for reasons of different kinds. Most notably, institutions such as the IMF, World Bank and regional development banks have advised government in developing countries to privatize their state-owned enterprises as part of their overall structural adjustment reforms, which are reinforced by domestic challenges: the need to adjust to rapidly changing market forces, create jobs, raise income levels and increase productivity and efficiency in order to compete in the global economy.

The world wide recession of the late 1970s, the debt crises faced by many Latin American, African countries during the early 1980s and shift to market economics in Asia, Eastern Europe and Latin American during the early 1990s all exacerbated the problem of state enterprises. Accordingly, attention was paid on the crucial role of the private sector in economic growth and development of the developing countries. The current surge in privatization has its roots in the deregulation in Canada and the United States in the late 1970s and in the movement towards divestment of public transport and utility companies in France, Germany and the United Kingdom in the early 1980 (Rondinelli, 1995:4).

The reorientation of international financial institutions such as World Bank and IMF towards macro-economic adjustment, economic stabilization, and market oriented development policies, coupled with conservative ideologies in aid-giving western industrial countries during 1980s, brought political pressure on developing countries to adopt market-oriented economic reforms. Since then the privatization movement developed so rapidly that governments all around the world are encouraging private sector to participate in providing goods and services previously offered by public agencies.

State Owned Enterprises (SOEs) and their Performances in Developing Countries

Despite the wave of privatization, enterprises in the public sector are functioning in many LDCs. Government involvement extends from regulating private sector activities to the outright production and distribution of goods and services through SOEs. Government intervention and prevalence of SOEs have stifled private enterprenuralship and initiative; diverted credit from productive activities affecting the standard of living of population (Zank, 1991:164).

During the past three and half decades, there has been rapid growth in the number and size of these enterprises in developing countries. In addition to their traditionally dominant presence in utilities (gas, water and electricity), transportation (rail roads, airlines and buses) and communications (telephone, telegraph and postal services), SOEs have become active in large-scale manufacturing, construction, finance, services, natural resources and even agriculture (Todaro, 1993;567). For example, in the past, in Senegal, Tanzania, Bangladesh, Burma, India, Mexico and Nicaragua; SOEs had produced more than 70 percent of the total output in natural resources. In Syria, Tunisia, Egypt and Ethiopia; SOEs accounted for 60 percent or more of the value-added in manufacturing (World Bank, 1990). Berg (1987) estimated that in LDCs, public enterprises accounted for approximately 10 percent of gross domestic product.

Privatization irrespective of its benefits is now sweeping the world. Since dethronement of communism in the Eastern block, only a few countries such as Burma, Libya, Cuba, and North Korea have remained out of the privatization regime. Countries as diverse as Malawi, Malaysia and Mexico have become enthusiastic for the privatization programme. Even the People's Republic of China also has launched promisingly the privatization programme as she opened her economy for the rest of the world in the 1980s.

A large share of investment is diverted in SOEs in most of the developing countries. However, the study of SOEs' performance reveals that these institutions do not contribute significantly in the GDP in these economies. For instance, in India, the public sector accounted for 62.1 percent of total productive capital and 26.7 percent of the total employment in 1980. By contrast, it had produced only 29.5 percent of value-added in manufacturing and while SOEs had absorbed about half of total investment and therefore presumably should have been able to earn a sufficient return to finance additional investment. Unfortunately, gross savings in the public sector never exceeded 4.4 percent of GNP upto 1982 (Bardhan, 1984:97-104).

India adopted the strategy of privatization by gradually reducing the budgetary support for unprofitable public sector enterprises by bringing such ailing enterprises under the preview of the "Board of Industrial and Financial Reconstruction, by offering shares to financial institutions and general public by setting up her Dis-investment Commission (Meena, 2000:88). India has been taking cautions approach to privatization programme on account of the country's unemployment situation, the government's fear of large scale job losses and fierce opposition to this drive from various trade unions in the country.

3. Dynamics of Privatization in Nepal

After the collapse of most of the industrial ventures of the 1930s, some rudimentary industries were set-up in the country in the form of agro-processing and lumbering (grain husking, oil seed extraction, jute processing, tea production and lumber milling) in the 1950s. This was followed by the establishment of construction material producing units and some import substitution units such as beverages, cigarettes, textiles, agricultural tools, furniture and domestic implements in the 1960s.

The carpet and garments industries and a nascent mining industry based primarily on magnesite extraction have emerged in the 1990s. Large scale manufacturing is undertaken by public enterprises in or around Kathmandu valley. Outside Kathmandu valley, industrial production is almost exclusively of the nature of cottage and small-scale industries, which serve the subsistence economy of Nepal. Thus, industrial sector of Nepal mainly comprises cottage and small-scale industries and some ventures that manufacture carpets, garments, noodles, baked goods, home spun clothes, handicrafts, silver ornaments, metal goods, hosiery; etc.

It is found that high priority has been given to public sector undertakings (SOEs) in Nepal from Second Plan to Seventh Five Year Plan, Nepal gave high priority to). Most of the public enterprises in Nepal were set up in 1960s, funded mainly through foreign aid. In this period there was an upsurge in the number ofSOEs, largely supported by countries, particularly China, Russia and India. During 1960 to 1990 around 60 public enterprises came into existence in Nepal of which 21 were in manufacturing sector, 10 were in public utilities, 8 in finance, 15 in trading and 7 in social service sector. Unlike in other countries, the establishment of these enterprises in Nepal was not guided by specific objectives rather they were established as an attempt to solve the problems arising out of a particular situation, opportunities arising out of receipts of foreign aid, and the existence of a very weak private sector incapable to undertake even the most elementary productive and distributive function (Reejal, 1995:39-41). The public sector enterprises (SOEs) still dominate the industrial infrastructure base in the Nepal (Pyakuryal, 1995). This sector has contributed to the tune of 6 percent to the Gross Domestic Product (GDP) in 1990/91.

3.1. Privatization Drive

It was at the end of the 1970s that the Nepalese planners and policy makers realized the limitations of the government and need was felt to mobilize the private sector for the upsurge of industrialization in the country The Seventh Plan of Nepal (1985/86-1989/90) reiterated the intention of removing excess government control on the day to day affairs of public enterprises (SOEs). During this period, the government also showed its intention in divestiture of shares of 12 state-owned enterprises. But these activities were never executed.

These public enterprises are still absorbing more than 20 percent of the overall government budget. In 1995/96 net cash flow to various public enterprises from Nepalese government amounted to Rs. 1,835 million and estimated that it would increase up to Rs. 2,830 million for 1995/96 and even more for the fiscal year 1996/97. Similarly, the government's investment in public enterprises at the end of fiscal year 1994/95 amounted to Rs. 8,618.5 million in equity and Rs. 26, 419.3 million in loans. Up to the fiscal year 1991/92, the net loss of public enterprises was recorded Rs. 1,145.5 million (Economic Survey, 1995/1996:52). In fiscal year 1997/98, the capital employed in public enterprises reached to the tune of Rs. 81 billion. However the gross profit figure was stood at 1.62 percent. For the last four decades, the average rate of return from public enterprises was calculated to be around 1.46 percent (Manadnar, and Bajracharya, 2000: 108).

After the reinstatement of the democratic government in the early 1990s, realizing and reviewing the dismal performances of public enterprises, the government decided to privatize three public enterprises in the fiscal year 1991/92 under the first phase. Together with this, the decision to privatize the Harisiddhi Brick and Tile Factory, the Bansbari Leather Shoes Factory and Bhrikuti Paper Mills was also made public (NPC, 1992:690-692). Donor advice especially that of World Bank, UNDP and USAID has been instrumental in accelerating Nepal's privatization program since 1988-89.

A policy paper on privatization was issued by government of Nepal in 1991 which laid down the policies, modalities and administrative mechanism for privatization of public enterprises. In 1994, the "Privatization Act" came into force. The preamble of this act spells that, "whereas in order to increase the productivity through enhancement of efficiency of the state owned enterprises of the kingdom of Nepal and thereby, mitigate the financial administrative burden to the government, and to usher in all-round economic development of the country by broadening the participation of private sector in the operation of such enterprises, it is expedient in the national interest to privatize such enterprises and to make arrangements therefore" (Rastrasewak, 1995:3).

The government started the process of privatization of 14 public enterprises in the second phase program. Among these 14 PEs, Nepal Film Development Company Limited, Balaju Textile Industry, Raw Hide Collection and Development Corporation, Nepal Lube Oil Limited and Nepal Bitumen and Barrel Limited were privatized during second phase In addition, Jute Development and Trading Corporation and Tobacco Development Company were also liquidated. The other public enterprises to be privatized in the second phase were, namely Dairy Development Corporation, Agro-Tool Industry, Nepal Coal Limited, Nepal Tea Development Corporation, Seti Cigarette Factory, Nepal Metal Industry, Jute Development and Trading Corporation and Raghupati Jute Mill. The second phase of privatization process in Nepal had been completed in the late 1997, the third phase of program was induce from the beginning of 1998.

In 1998/99 His Majesty's Government sold partially Nepal Bank Limited's share to the general public. Furthermore, progress is being made towards the completion of the privatization process of Nepal Tea Development Board and Himal Cement Company, which were initiated in the financial year 1997/98. Likewise, privatization of BCP (Butwal Power Company) by offering 75 percent of its blocks shares to the private sector was executed. The privatization process of Rastriya Banijya Bank and Nepal Bank Limited have been already initiated by offering 10 percent share to its employees as well as management contract with an American Company. By the end of the Ninth Plant (1997-2002), the government had set the target to privatize 30 different state owned enterprises of Nepal.

3.2 Procedures of Privatization

Privatization of the first three SOEs in Nepal had been initiated hastily through outright sales of ownership assets and business based on liquidation value. Gaining experience in the first phase, HMG began to take more pragmatic approach towards privatization in the second phase after an intensive consideration of asset value. In both the first and second phase of privatization, management held the majority of shares as promoters and financiers of privatized enterprises. This varies from the lowest of 62 percent management ownership in Nepal Lube Oil Limited to the highest of 95 percent in Raw and Hide and Skin limited. In most of the privatized SOEs, workers and employees were allocated 5 percent of the total shares although their shares had been increased to 29% in Nepal Film Company (Regmi, 1996:397-398). Up until now, a total of 17 SOEs have been privatized in the country out of which Nepal Tobacco Development Company and Nepal Jute Development and Traiding Company were declared liquidated (Adhikari and Adhikari, 2000: 107)

3.3 Outcome of Privatization in Nepal

The effect of privatization is mostly discerned in the level of employment investment in the country. There has been a marked decrease in the level of employment in almost all privatized industries, except in Bhrikuti Pula and Paper factory. The exact effect in the level of employment is reflected in the following table.

Table. 1 Employment situation of public enterprises before and after privatization

Name of Enterprises	Before Privatization	After Privatization
Bhrikuti Pulp and Paper	297	576
Harisiddi Brick and Tile	602	54
Bansbari Leather and Shoe	478	70
Nepal Film Devt. Corporation	87	54
Balaju Textile	196	101
Nepal Lube Oil	120	91
Nepal Biteiman and Barrel	58	46
Nepal Foundry	65	20
Raghupati Jute Mill	1,114	1,446
Agriculture Tool Factory	283	278
Total	**3,210**	**3,227**

Source : (DAN: 1999).

Table 1 reveals that the number of employees after privatization has been declined by 736 persons. There was 19 percent decline in employment level particularly after privatization in the above mentioned selected privatized enterprises. However, there is no uniform change in the level of employment in above mentioned enterprises.

A study on privatization reveals that investment made by private sector in the economy seems to be less promising in spite of the launching of privatization and liberalization programmes in Nepal. To be precise, private sector investment had increased by just 6 percentage points as against public sector investment during 1991-1997 (Mathema and Sigdel, 2000: 19 - 20).

The success of an enterprise is generally reflected in its capacity utilization, which did not show any marked improvement in the privatized industries (Table 2 below).

Table 2 Efficiency parameter of selected privatized enterprises (In percent)

Name of Enterprises	Years					
	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97
Bhrikuti	-	-	84	70	27	-
Bansbari	-	40	80	40-	80	75
Nepal Foundry	-	-	29	-	20	37
Raghupati Jute	45	-	-	-	35	56
Bhakpapur Jute	72	62	60	52	75	59

Source : MOF (1999: 16-44).

The capacity utilization trend of five selected enterprises is erratic in nature. This is the reflection of the struggle of privatized enterprises of Nepal for their survival. However, there has been a mixed growth in the overall out put of the privatized enterprises as has been shown in the following table.

Table 3 Level of Output Before and After Privatization

Name of Enterprises	Before Privatization	After Privatization
Bhrikuti Pulp and Paper	2665 (MT. Paper)	7659 (MT. Paper)
Bansbari Leather and Shoe	110000 (Shoes)	---
Harisiddi Brick and Tile	1243000 (Sq.ft.)	2303000 (Sq.ft.)
Nepal Film Devt. Corp.	---	21 (Films)
Balaju Textiles	11640 (Meter)	538198 (Meter)
Nepal Bitumen and Barrel	---	---
Nepal Lube Oil	945 (Kl.ltr.)	937 (Kl.ltr)
Nepal Foundry	103000 (kg. iron & steel)	371374 (Kg.)
Raghupati Jute Mill	3384 (Mt.)	6502 (Mt.)
Bhaktapur Brick	1175000 (Pcs. bricks)	10961999 (Pcs. bricks)

Source : (MOF: 1999).

After privatization some enterprises might have conceivably changed their methods of production as well as management. In case of Bhrikuti Pulp and Paper, Harisiddi Brick, Nepal Foundry, Raghupati Jute Mill and Bhaktapur Brick; after privatization their output rose promisingly. Unfortunately, the other privatized enterprises did not perform to the expectation. The enterprises such as Nepal Lube Oil, Nepal Bitumen and Barrel and Bansbari Leather showed disappointing performance after privatization.

Paradoxically, after privatization, the price level of the products have increased significantly over the years reflecting an increase of almost 50 percent, 142 percent and 119 percent respectively in the price of brick, roof tile and floor tile of Harisiddi Brick and Tile Factory (CPS, 2000: 16). Likewise, per meter price of textiles produced by Balaju textiles had also increased from Rs. 27.60 to Rs. 41.90 after privatization. However, the revenue accrued to the government from the enterprises have increased fairly after privatization.

3.4 Privatization Pace

The pace of privatization drive in Nepal has found to be painfully slow as mentioned by WB, Kathmandu, in 2000. From 1992 to 1997, nearly sixteen enterprises were privatized. The pace was somehow promising. But in between 1998-2000, the only one enterprises, i.e., Nepal Tea Development Corporation was privatized. In the late 1999, 25 of 7 existing public enterprises including cement, tea, and power were identified for privatization. The Ninth Plan (1997-2000) had aimed to privatize almost 30 enterprises, but the Government had totally failed to do so by the end of the plan. Efforts to privatize BPC have been dogged with controversy. The privatization of the Himal Cement Company still awaiting completion (Poudyal, and Sigdel, 2001: 67). The multilateral donor agencies are insisting Nepal for the speeding up privatization of the two banks, i.e., Rastryia Banijya Bank and Nepal Bank Limited and two public utilities, namely, Nepal Telecommunication Corporation and Nepal Drinking Water Corporation. Recently management contract of RBB with an American Company has been already completed while the Western Rural Development Bank's privatization process is on the way (The Kathmandu Post : 2001).

4 Conclusion

Most of the public enterprises in Nepal are sick, incompetent and economically poor. Though public enterprises have particular problems, some problems are common: (a) regular intervention by the government in their daily affairs, (b) appointment of government bureaucrats in top management who very rarely fulfill their responsibilities, (c) the public enterprises have been manipulated as the employment centers by politicians, and (d) the absence of a link between the survival of the PEs and their performance

The financial performance of Nepal's public enterprises have been persistently poor, with government and foreign loan transfers and overdrafts being more than 30 percent of budget deficit.

The review the privatization of public enterprises in Nepal reveals that programme as such seems more political and less economic. The privatization drive has not been very successful in generating the desired level of economic growth in terms of output, employment, investment and has created chaos in the labour market among the laborers. It has also created illusion among the public and has become pro-rich instead of pro-poor. Furthermore, privatization programme, as such, has failed to attract FDI for. A number of factors have hindered privatization drive: (i) labour problem (ii) environmental issues (iii) failure of bids to meet technical qualification and (iv) low valuation of the enterprise assets. Above all, lack of transparency in the process (as is evident form the protracted bidding process for the BPC) also hindered privatization (WB, 2002: 15). In addition, the divergent voices and vision between ministers and the advisers of the government and lack of strong commitment on the part of the Government have also become one of the factors for the mixed outcome of privatization programme.

The advantage of privatization programme can be maximized when the government assures a competitive environment by way of reducing cost has adequate procedures and provision to promoting service quality, strong support to small and medium scale enterprise development as well as restructuring of SOEs, and perform an effective regulatory role which minimizes corruption and inequality. The process of privatization should be complete transparent from all angles and cautions should be taken to make market business friendly. Moreover, maintenance of labour and social welfare is a must. Similarly, strengthening of monitoring and evaluating mechanisms must be developed.

Selected References

Adhikari, Ratnakar and Kamalesh Adhikari (2000). *Privatization : Expectation and Reality*, Forum for protection of public interest, Kathmandu.

Bardhan, Pranab, *The Political Economy of Development in India*, Bosil Blackwell, Oxford, 1984.

Beesley, Michael and Stephen Littlechil (1996). Privatization: Principles, Problems and Priorities in Bishop, M., J. Kay and C. Mager (ed.) *Privatization and Economic Performance*, Oxford University Press, New Book, London.

Cavendish, Christopher and P.S. Misty (1992). Adjusting the Privatization: Case Studies from Developing Countries, James Currly Ltd. London.

Centre for Policy Studies (2001). *Enabling Private Sector: A Research Report Prepared for DFID*, CPS, Kathmandu.

Council of Retired Public Servants (1992). *Rastrasewak* (Quarterly Journal), Vol. 1, No. 3, Kathmandu (Summer 1992).

Hartley, K. and D. Parker (1991). Privatization: A Conceptual Framework in Ott, A.F., and K. Hartley (ed.) *Privatization and Economic Efficiency: A Comparative Analysis of Developed and Developing Countries*, Edward Elgar Publishing House, U.K.

His Majesty's Government (1996). *Economic Survey 1995-1996*, Ministry of Finance, Kathmandu.

Kikeri, Sunita, Nellis John and Shirley Mary (1992). *Privatization: The Lessons of Experience*, The World Bank, Washington, D.C.

Krueger, A.O.(1992). *Economic Policy Reforms in Developing Countries*, The Kuznets Memorial Lectures, Blackwell Publishers, USA.

Manandhar, N: and P. Bajracharya (2000). Privatization in Nepal in Gopal Joshi (ed.), *Privatization in South Asia*, South Asian Multidisciplinary Advisory Team/ILU, New Delhi.

Mathema, K.B, B.D. Sigdel (2000). *Privatization Drive in Nepal*, in 'Liberal Times' Friedrich-Naumann - Stiftung (FNS), Vol. VIII/No. 2 New Delhi.

Meena, J.P. (2000). *Experience of Privatization in India with Particular Reference The State of Assam*, in 'Privatization Experience in South Asian Countries', APO, Tokyo.

Ministry of Finance (1994). *Budget Speeches of the Fiscal Year 1994-1995*, His Majesty's Government.

Ministry of Finance (1996). *Budget Speeches of The Fiscal Year 1996-1997*, His Majesty's Government.

MOF (2000). *Economic Survey (1999/2000)*, Ministry of Finance, Kathmandu.

MOF (1999). *Monitoring Privatized Enterprises*, MOF, Kathmandu.

Poudyal, S.R. and B.D. Sigdel (2001). *Private Sector Development*, in Stephen J Keeling 'Pro-Poor Governance Assignment Nepal', ESP/DFID, Kathmandu.

NPC (1992), *The Eighth Plan (1992-1997), National Planning Commission*, Kathmandu.

NPC (1997), *The Ninth Plan (1997-2000)*, National Planning Commission, Kathmandu.

Pyakuryal, Bishwambher (1995). *Impact of Economic Liberalization in Nepal*, Santosh K. Nair, Kathmandu.

Reejal, Pushkar R. (1995). *The Political Economy of Nepal Since Fiscal Year 1980-1990*, Indira Reejal, Kathmandu.

Regmi, J.R. (1996). *Nepal Country Paper on Privatization*, in 'Privatization and State Owned Enterprises', Experiences of Asia and Pacific Economy, APD, Tokyo, November.

Rondinelli, Dennis A (1995). Privatization and Economic Transformation: The Management Challenge in Prokopendo, J. (ed.), *Management for Privatization: Lessons form Industry and Public Service*, ILO, Geneva..

The Kathmandu Post, Feb. 9, 2002.

The Rising Nepal, Gorkhapatra Shanstham, September 22, 1995.

Todaro, M.P. (1993). *The Economic Development in the Third World*, Orient Longman, New Delhi.

WB (2002). *Economic Update- 2002*, Prepared by World Bank for 'Nepal Development Forum', WB Kathmandu, January 13, 2002.

WB (1997), *World Development Report - 1997*, Oxford University Press, USA, 1997.

Zank, Neal S. (2001). Prospective on Privatization in LDCs: Encouraging Economic Growth and Efficiency in Ott, A.F., and Hartley, K., (ed.) *Privatization and Economic Efficiency: A Comparative Analysis of Developed and Developing Countries*, Edward Eager Publications, U.K.