

Industrial Development in Nepal: A Critical Review

***Binod Kumar Gupta**

Research Scholar

**Department of Commerce and Business Administration,
Lalit Narayan Mithila University, Darbhanga**

****Dr. Diwakar Panjiyar**

Retd. Associate Professor

**Department of Commerce
Mahatma Gandhi College, Darbhanga**

Abstract

The Industrial revolution period was from the 18th to the 19th century when major changes in agriculture, manufacturing, mining, transportation and technology had a profound effect on socioeconomic and cultural conditions of the times. Industrialization is a complete new phenomenon in Nepal. The Biratnagar Jute Mills set up in 1936 marked the beginning of organized industry in the country. In the years that followed industries like Morang cotton Mills in 1941, Morang Sugar Mills in 1946, Raghupati jute Mills in 1946 and the Juddha Match Factory in Biratnagar was set up in collaboration of Indian Businessmen. However industrial development in Nepal started regular attention from 1951 onwards with the dawn of Party less Panchayat regime. The economic philosophy of the party less political system was Mixed Economic Philosophy. The private sector was reluctant to invest due to Autocratic handling of economy as such several industries were established in public sector mostly with the financial and technical assistance of USSR and China.

Key words: *Foreign Investment Policy, Industrial Development, Industrial Policy, Public Enterprises, Socio-economic.*

Introduction

Public Enterprises assumed significant role in almost every countries of the world. Yet there has so far been no standard definition of its own. The term 'Public Enterprise' has been defined differently by different agencies and governments to suit their own respective situations. U.N. has defined PE as "those organization, namely governmental enterprises and public corporations, which are entirely or mainly owned and/or controlled by the public authorities consisting of establishments which by virtue of their kind of activities, technology and mode of operation are classified as Industries". The Seoul Workshop on Performance of Public Enterprises held in September 1975 defined PEs as "all productive entities/organizations which are owned and/or controlled by public authorities and where output are marketed". It had further clarified that: (a) "Productive entity or organization"

refers to an identifiable decision making unit with an explicit or extractable budget and which produces goods or services".(b)"Ownership" refers to such entities or organizations whose more than 50 % of outstanding equity is held by a "public authority" either "directly" or "indirectly".(c) "Control" means the power to be involved in the management of the enterprises through the appointment of top management, members of the board of directors and the chief executives. (d) Output is said to be "marketed" if sales cover more than 50% of current costs. Current costs here refer only to intermediate inputs and returns to factors not owned by the enterprises, and constituting largely wages and rent. Thus, public enterprises usually refer to commercially creating organizations wholly, or partly owned and controlled by a public authority. Under this definition units producing marketable products falls under PE. In our context, they can be excluded since their source of financing, preparation of financial statements etc, differ widely from that of other non-departmental autonomous enterprises. These PEs are incorporated in one legal form or the other, other than as proprietorship or partnership. Therefore, their legal status depends on their incorporating acts viz (a) Company Act (b) Special Statute (c) Corporation Act (d) Communication Corporation Act and (e) Commercial Bank Act.

History of Industrial Development in Nepal

In Nepal, industrial development started rather late due to the closed socio-political and economic status of the country during the Rana Regime. So, the history of industrial in 1936. Thereafter, in 1940, (i.e. information dissemination about cottage level skill- based enterprises) was established. The early and gradually developed industries were cigarette and match factories. Raghupati Jute Mills established in 1946 is regarded as the first modern industry of Nepal (Khatri, 2018). The development of industrial sector is a crucial to attain prosperity, generate employment, alleviate poverty, promote trade and stimulate growth of national income. But the industrial development of Nepal over past decades remains not much satisfactory. The manufacturing sector employed just 6.6 percent of the total workforce (NLFS, 2008). The contribution of manufacturing to total GDP was a minimal 6 percent in 2010. Most industries are located around various urban areas of the nation like Kathmandu Valley, Biratnagar, Simara, Birgunj, Hetauda, Pokhara, Butwal, Nepalgunj and other places of the Terai region (CBS, 2014).

The evolution of PE in the world has taken place in such a way that one can hardly find any government remaining aloof from the industrial enterprises, though the degree of involvement may vary. In fact, the very characteristic of the present century has been the acceptance of the role of the state involvement in the economy, no matter how loud the whole world cry for the total role played by the private sector. Even PEs do exist in a country like

U.S.A., where the stronghold of private enterprises exist. The U.S. makes the least use of the PEs. The U.S. has disbanded most of the PEs that expanded considerably mainly to meet the financial and procurement purposes. For the purpose of dealing with emergency requirements of the two World Wars and the Great Depression of the 1930, it has founded Tennessee Valley Authority (TVA) in 1933, a unique PE setting an example to be imitated by many countries to undertake integrated development of great river valleys, irrigation, flood control, navigation, soil conservation and the generation of hydro-electric power. The former British Minister for Overseas Development once remarked "We now need to extend the concept of intervention and planning from the national to the international level, from the nation to the world, from the country to the planet. We must now determine that we shall solve our shared and common problems only by a firm rejection of any illusion that there is a free world market economy". The need of the PE was far greater felt especially during the Post world war period and the great depression of the thirties, though the need of it went on emphasizing with the adoption of development planning since 1950s.¹ Each sector private as well as public has its own merits and demerits depending upon the ideology, resources available, regulation, consciousness, control, monitoring, and supervision mechanism etc. Former Prime Minister of India Mrs. Indira Gandhi once remarked "A people steeped in poverty are naturally impatient for an ending of disparities and for the opportunity for a better life. Many projects have to be taken in hand. Development cannot be left to the mercy of market forces. For is it feasible for the private individual or group to finance the vast investments involved. State intervention is, therefore necessary. and, we must fulfill our pledge to give social and economic justice to our people" Whereas former President of Korea Park Chung He insisted "Private ownership of production should be unconditionally encouraged except in instances where it is necessary to control it to stimulate national development and protect the interests of the people".

Pre-plan Period

Pre-plan period marks the period of almost non-existence of any government policy towards PE. Nepal Bank Ltd was the single PE established prior to the launching of the planned development policy in 1956. Therefore, virtually no development of PEs took place during the period. Nepalese economy was characterized by lack of basic infrastructure, support services, essential basic industries and so on. Illiteracy rate was quite high. Private Sector was also not developed. The country lacked resources both financial as well as non-financial including sufficient human resources comprising of entrepreneurs so necessary for the proper socio-economic development of the country.

Post-plan Period

The post-plan period marks the significant era in the process of fostering the development process of Nepal. The Cooperative Movement was started in 1950's to develop the vast rural economy and to modernize the agriculture sector so that the majority of rural farmer could participate in the process of national development. HMG facilitated organization of co-operatives in 1956 under the Multipurpose Development Project in Rapti Valley by giving an executive order providing for resettling of landless farmers.

Flow of Fund Between His Majesty of Government and Public Enterprises

As regards the financial performances of PEs, notwithstanding the fact that they differ in their ages of establishment, Return on Net Capital Employed which stood at 5.8 % in F.Y. 1970/71 stood at a minus 4.7 % in F.Y. 1980/81 and minus 2.6 % in F.Y. 1984/85. However, it recovered to 1.4% in F.Y. 1985/86, 3.5% in F.Y. 1986/87 and .65 % in F.Y. 1987/88. It was estimated to be 1.09 % in F.Y. 1989/90 though the 1988/89 figure was a negative return of .22 %. However, the losses in the F.Y. 1988/89 as compared to prior years have been attributed to the trade and transit impasse that arose with India at that time. In the F.Y. 1988/89 trade sectors have incurred losses of Rs. 214.5 million and the financial sector Rs. 79.7 million. However, service and public utility sector PEs made & respective profit of Rs 46.8 million and Rs 19.4 million. Inclusive of losses in the F.Y. 1988/89, the cumulative losses of corporations is believed to have reached Rs 2680 million in the F.Y. 1988/89.

Industrial Policy

The Industrial Policy was announced in 1992. It is comprehensive in coverage and is in line with the principles of free-market economy. The policy has opened up new frontiers for joint venture activities in the country. Participation of the private sector has been encouraged, particularly for the industrial development of the country.

The market entry, expansion and modernization of business and industrial firms have been made easier by means of liberalized and simplified procedures. Licenses are no more required for establishing, expanding and upgrading industries except for those industries related to defense and public health and for industries involving foreign investment.

The Industrial Policy, 1992 spells out its objectives, policies and strategies. The objectives of the Policy are as follows:

- To increase the contribution of industrial sector to the national economy through the enhancement of industrial production and productivity;
- To put emphasis on the development of the industries utilizing local resources and industries which are export oriented;
- To reduce the pressure of unemployment and underemployment in the agricultural sector through the development of employment generating industries;
- To adopt appropriate policy conducive to industrialization for the all-round balanced development of the country.

The Industrial Enterprise Act, 1992 incorporates the guidelines of the Industrial Policy in its legal provisions. The main provisions of the Industrial Enterprise Act are as follows:

- The Policy has assigned the Government the role of a facilitator for creating a congenial atmosphere for the healthy growth of the industrial sector.
- The Policy fully encourages private sector participation and the private sector has been assigned full responsibility for the development and promotion of industrial activities.
- The Policy attracts foreign investment in the form of equity, loan and technology transfer or any form of collaboration.
- The Policy calls for the simplification of administrative procedures (e.g. a license is not required for the establishment, extension and modernization of industrial enterprises, except for defense, public health, and environment-related industries).
- The Policy ensures all kinds of services to the industries through a one-window system.

- Additional facilities are provided to export-oriented and national priority-oriented industries (e.g. food, cotton, leather engineering, chemical, tourism, hydropower, service-oriented and mineral-based industries)
- Additional facilities and incentives are provided to the industries established in the remote or underdeveloped or less developed districts of the country.

With the enforcement of the Industrial Policy, 1992, major changes have been felt in the industrial environment of the country. This policy has been instrumental for launching new economic policies and reforms in the country. The industrial sector has been freed from the clutches of licensing and control.

The policy's main purpose is to attract foreign direct investment. Hence, the barriers and blocks to foreign investment were removed. The policy gives additional incentives to the cottage and small-scale industries. For instance, the cottage industries could be registered within six months after they come into operation, and there is no income tax, sales tax and excise duty imposed on the traditional cottage industries.

Special provisions are also made for institutional support and financial backup to these industries. Facilities have been provided to industries on the basis of their location and the national priority. The Government assumes the role of a facilitator for creating congenial atmosphere for the healthy growth of industrial sector. The policy fully encourages private sector participation, and the private sector has been assigned full responsibility for the development and promotion of industrial activities.

Foreign Investment Policy

The Industrial Policy, 1992 has encouraged foreign direct investment in the country to a considerable extent. To strengthen this process, the Government also adopted the Foreign Investment Policy in 1992. In consonance with this policy, the Foreign Investment and Technology Transfer Act (FITTA) were enacted in the same year. FITTA was later amended in 1996. This Act is thus the main specific legislation governing foreign investments in Nepal.

The Government's intention is to increase the flow of foreign direct investment into the country and reduce Nepal's excessive reliance on external debt and borrowing. The other purpose is to encourage transfer of technology, which, in most cases, accompanies foreign

investment. In order to promote foreign direct investment, the Government also employed a mix of trade reforms, several liberalization measures and macroeconomic adjustments.

As defined by FITTA, a foreign investor can make direct investment in an industry in any of the following ways:

- Investment made in the Investment in shares (equity),
- Reinvestment of the earnings derived from the investment as referred to in (1) above, and
- Form of loan or loan facilities.

FITTA also defines "technology transfer" as any transfer of technology to be made under an agreement between an industry and a foreign investor on the following matters:

- Use of any technological right, specialization, formula process, patent or technical know-how of foreign origin.
- Use of any trademark of foreign ownership.
- Acquisition of any foreign technical, consultancy, management, and marketing service.

FITTA provides several facilities and concessions to industries, which are established through foreign investment. These facilities relate to four main areas: (i) repatriation facilities, (ii) land facilities, (iii) tax incentives, and (iv) other miscellaneous facilities. FITTA, however, prohibits foreign investment in certain sectors. For example, manufacturing of items having negative impact on public health, manufacturing of defense and military materials, and establishment of small-scale business are prohibited for foreign investment. The major provisions of the Foreign Investment Policy are as follows:

- 100 percent of foreign investment is allowed;
- Foreign investment in large and medium scale is allowed;
- Full remittance of profits, dividends and repatriation of capital is allowed;

- Provisions for the transfer of technology in cottage and small industries has been made;
- Security of foreign investment is guaranteed;
- Attractive facilities, incentives, concessions are given to industries; and
- Quick and efficient services to foreign investors are provided under the one-window system.

Nepal needs foreign capital and technology for its economic development. It has been inviting such capital since it started planned economic development in 1956. However, it was only official capital, which was flowing into the country. It is now widely realized that official capital alone is not sufficient. This too is decreasing during recent years. It was in this context that the FITTA was enacted.

Privatization is a subject of vital concern to the business community as well as its stakeholders. Privatization is now being considered as an approach to stabilizing and developing the national economy by strengthening the participation of the private sector in nation building. Privatization scheme is often launched as part of a public sector reform or a sectoral adjustment program. Hence, privatization, in essence, involves the divestment of the existing interests of the government, as part of its strategy, in favor of the private sector.

In the 1980s, a new wave of thought and range of alternatives for public sector improvement were witnessed throughout the world. An era of privatization emerged as an alternative strategy for public sector reforms. Many developing countries in Asia also initiated privatization moves. They privatized many of their public enterprises.

The policy of privatization in Nepal was specified, for the first time, in the Sixth Plan. Such a policy has been incorporated in all the subsequent Development Plans. In addition, the Government has made a number of Cabinet and Ministry level decisions on such policy from time to time. In 1985, about 12 public enterprises were planned for privatization. This ambitious plan could not, however, be materialized. The Government then decided to sell the shares of some of the leading financial institutions to the general public at premium prices.

Conclusion

Industrialization and industrial development are recognized as the principal of sustainable economic growth to provide stability and development, but its development trend is slow and challenging up to now as well as its contribution in GDP is less than 10 percent. In Nepal, plans and policies reform efforts of over 60 years for the development of the

industrial sector, but unable to improve economic performance through this sector. Similarly, the industrial infrastructure, entrepreneurial skills, technological capability, political will power and good governance constitute the key problems of industrial development. As a result, the country is facing an ever rising negative balance of trade as well as balance of payments situation. However, Nepal has a potentiality of hydro-power, tourism, herbal products, agro-processing, and human resource development. Accordingly, with the hope of more stable governments at federal, provincial and local level, a positive and enabling environment is required for the development of the industrial sector.

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