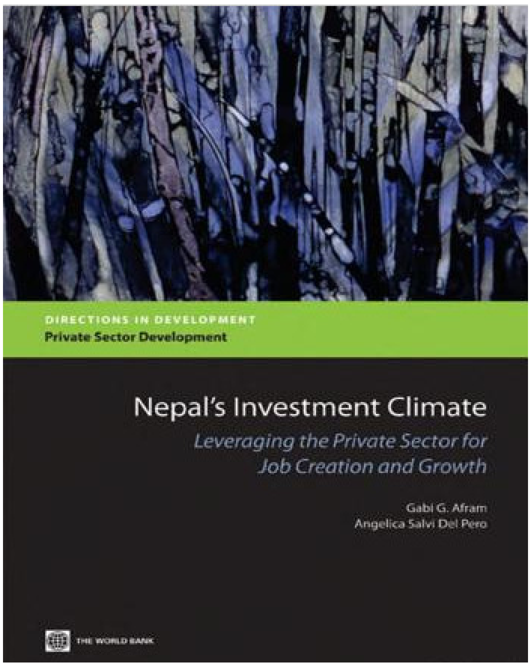
Book Review

- Mahesh Banskota

Afram, Gabi G., Del Pero, Angelica Salvi. (2012). *Nepal's investment climate: Leveraging the private sector job creation and growth.* Washington D.C.: The World Bank.



At a time when much recent writing on Nepal has focused on the political stalemate, *Nepal's Investment Climate Leveraging the Private Sector Job Creation and Growth,* by Gabi G. Afram, Del Pero and Angelica Salvi, without discussing politics, illustrates the damage that bad politics is having on the economy. The book is about the private sector in Nepal including the impact on the Tourism sector. The main sources of information the authors use are three separate surveys – Enterprise Survey, Employee Survey and the Informal Survey – specifically undertaken for assessing the Investment Climate in Nepal. The Enterprise survey in particular is similar to what the World Bank has completed in other countries, making it easy to compare Nepal with other countries. The book is divided into eight chapters. It begins with an Executive Summary, followed by Reports Highlights.

Chapter 1, the Introduction, presents an overview of the economy. The two important points highlighted include the growth in the economy driven by consumption, and growth of services supported by increasing remittances. The authors reiterate that Nepal may already be in the grip of a Dutch disease. This is a situation where remittance liquidity inflates prices of goods and assets, and increases the costs of job creation in the country. Unable to compete, exports decline with growth of joblessness at home. Policy makers find it difficult to channel remittance to job-creating sectors, and job remains low and migration continues, which soon becomes a vicious cycle, entrenching inflation and unemployment.

In the condition that remittance slows down, there is a fall in real estate prices, which also strains financial institutions, and erodes depositor confidence. There might be large scale shift of currency hoarding from NC to IC, increase current accounts deficit, put pressure on exchange reserves, and the exchange rate peg, pushing inflation further. This would further erode tax revenues and lead to a host of other adverse effects – potential nightmares for the economic planners.

The authors further point out that the challenge for Nepal's policy makers is to make better use of remittances, particularly to improve investment climate,

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so that those receiving remittances are encouraged to save and invest. Governments cannot directly influence these decisions. It is only improved investment climate that can encourage private investors.

The second chapter reviews the investment climate in the formal private sector. Political instability is ranked by private firms as the most important obstacle for improving the investment climate. This is followed by lack of electricity, access to finance and poor transport. Corruption comes next. Labor regulation is next although the bigger firms rate labor regulation higher than corruption. The study points out that labor regulations in Nepal are far more rigid than in comparator countries. Another interesting finding is that exporting firms are less constrained by political instability than non exporting firms. Enterprises managed by women face serious constraints with regards to access to land, skilled labor and even finance. Access to finance appears to be a very serious problem for smaller firms, which is a visible setback to Nepal since most firms here are small. The use of improved technology is also limited and exporting firms are better at using this than others. Private firms indicate that tax bureaucracy appears to be less difficult than in other comparator countries. The prevailing court system is reported to be quite fair. Although transparency International has ranked Nepal 143 out 180 in corruption index in 2011, only one in five firms see corruption as a serious problem.

The conclusion of this chapter indicates ineffective politics and inadequate infrastructure as the most serious obstacles for the private sector investments. It may be noted that these are also the two basic issues addressed by Nitish Kumar when he took over as the Chief Minister of

Bihar in 2005. Since then he has successfully transformed the investment climate of Bihar. It is not the case that our political leaders are ignorant about the transformation of Bihar. Many have also officially interacted with the Bihar government. So the question remains: When will a Nepali 'Nitish Kumar' take over the politics and transform Nepal in a similar zeal and commitment?

Chpater 3 goes into the details of the enterprises. Tourism and export related enterprises appear to be performing relatively better than manufacturing. In spite of increasing sales and employment, very low labor productivity has become a very serious problem in private sector enterprises across the board. All the comparator countries show much greater labor productivity than Nepal.

Chapter 4 is about the miserable state of Nepal's infrastructure. The book describes the infrastructure as very limited, old, poorly maintained. The fact is that the existing infrastructure projects in roads, and power and drinking water are all seriously bedeviled by labor problems and political interference. Funding constraints for infrastructure could be mobilized by using "Viability Gap Funding" (VGF), such as used by India to support private sector infrastructure projects that are unable to function break-even.

The main subject of Chapter 5 is the informal sector, which is very important for poverty reduction and a source of non-agricultural employment. The study finds that linkageswith the formal sector is weak and there are opportunities for greater subcontracting and franchising from the formal to the informal sectors. There are numerous problems faced by the informal sector and some suggestions are made by the study.

Chapter 6 discusses the issues regarding access to finance. In spite of a huge surge in financial institutions, access to finance for most small firms remains a serious problem. If there is the problem of inadequate coverage, with bulk of financial institutions concentrated in the central region, there is also the "need to broaden the range of assets acceptable as collateral through operationalizing a secured transaction registry" in Nepal. The authors argue that some efforts in this direction have not made any progress.
Chapter 7 introduces the subject of labor regulation in Nepal. The highlights of this chapter are rigid regulations, unionization, poor quality of Labor force in addition to the lack of wage differentiation by skills levels, and absence of labor courts. The tourism sector has almost 92 % permanent workers.

Chapter 8 discusses the external linkages of the private sector and the overall conclusion is that Nepal's economy is not as yet a part of the global economy. It is also not a part of the global value chain. At a time when China and India have been virtual leaders in the global economy, Nepal has been in a state of political turmoil, with little attention to promoting stronger external linkages. The chapter's last part highlights some of the problems that Nepal is facing with regards to the constraint in promoting external linkages. Factors such as lack of freedom of transit, cost of transport, rules and regulations for clearing, breakage and spoilage and the need to bring shipping lines to Inland Clearance Depots have been identified.

Chapter 9 discusses the Tourism sector which is of major interest to this review. Despite its being predominantly a private sector activity, all the earlier issues are also equally pertinent.

Nepal's tourism sector has picked up recently after the crash during the peak conflict days. However, for a country with such bountiful tourism resources, Nepal's tourism, compared to that of other countries, is still relatively small. With tourism accounting for 6.5 % of the GDP (in 2009), it is 145th in the list of countries. Tourism employment has been growing slowly but probably better than in most other private enterprises during the 2006/07 – 2009 review period. Its share in foreign exchange contribution has dropped from about 20% in 1992 to about 6 % in 2008. Most tourists come for holiday, followed by trekking, and pilgrimage. Business tourism is small. Tourists on an average spend 12 days which has been constant since 1995 – something for our policy makers to think about. It is reported that 23 % of air arrivals in 2009 were from India alone. Another limiting factor is that 54 % of hotels are all located in Kathmandu.

Average annual sales per year in tourism enterprises have grown at about 9% per year during 2007/8 – 2009 while overall growth for the other private enterprises for the same period was negative -0.3 %.

Employment in tourism sector tends to be larger than the average for the private sector. Lower skill of workers is a severe obstacle for growth. Over half of the firms in tourism made investments to improve their competitiveness. Only 1.5 % firms have internationally recognized quality certification. Poor infrastructure has also affected tourism sector. Share of the national airlines has dropped from 50 % to 25 %. Infrastructure outside Kathmandu is in even poorer condition. Power outage has forced firms to invest in their own supply. Internal funds are the major source of financing tourism investments.

Conclusions

- The remittance bubble like most other economic bubbles can also bust. If it does, there will be serious problems for the Nepalese economy.
- The only way to be better prepared for this inevitable bust is to (1) end political instability, (2) invest heavily in improving power and roads.
- Nepal's growth in tourism has been positive but other countries have done much better. Nepal needs to boost investment and capacity to take it to the next level of development.
- Export promotion must be given high priority because it is quintessential for improving labor productivity and for sustaining competitiveness of the economy. Tourism is an important component of this thrust.

If there is anything missing in this book, it is the discussion of the public and private sector institutions that help design, coordinate and implement policies. There are references to the role of different public sector organizations (infrastructure, tax, corruption-related) but there is no discussion of the different private sector organizations. The reason for this is that over the years private sector organizations have also been severely weakened by "politicization and polarization" according to party lines. This has seriously compromised the "clout" of the private sector to bargain with the political forces and labor unions.

There are important niche sectors like Tourism, education and other services that are growing and expanding employment. However, there are serious constraints to increasing investments in Nepal. Political instability, poor

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infrastructure, poor labor relations are critical concerns for immediate attention of both government and the private sector.

I strongly recommend this book to be read by leaders in the private sector and the government. It will be very helpful for the design of sound practical policies to boost the private sector in the future.