CONTRIBUTIONS TO NEPALESE STUDIES
CNAS, TRIBUVAN UNIVERSITY

VOL. 17, NO. 2
JULY 1990

PRIVATE SECTOR INVESTMENT IN NEPAL: POLICIES FOR THE FUTURE

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Introduction

In a labour surplus four-sector economy composed of household, business, government and the rest of the world, income, output, and/or employment is determined by the decision to save and invest. Investment is mainly financed by two major sources, say, internal and external, and is determined by benefit (B) and cost (C) considerations. Grater the B/C ratio higher the rate of profit earned. So long as B exceeds C the net present value is positive, and the marginal efficient of investment exceeds the rate of interest. Savings, instead, are the positive function of both of the income and the rate of interest. Attraction for saving also increase with the stability of prices.

As income grows, a greater gap between income and consumption is expected. But since the scattered savings (made mainly by the household sector) must be collected and brought into the mainstream of the financial flows, the role of both organised as well as unorganized financial (money plus capital) markets becomes significant. Meanwhile, the business sector, including the corporate and incorporate, interacts with sources of fund of internal and external origins, and also uses its own account saving, i.e., the undistributed profit, for investment. The main factors inducing investment are: rate of interest (cost of borrowing or the reward for saving), availability of credit, prospective future return from investment, technological improvement, market accessibility, laws regulating taxes, profits and imposing restrictions on private interest, and insurance against future uncertainty.

As investable fund is limited in amount, and therefore requires the effective use in various income yielding assets - both financial and real- e.g., bond, machinery, bank deposit, equity, etc. The basic problem for the investor, therefore, is how to make investment secure and to reap maximum benefit out of minimum involvement of fund in holding different assets. A wise investor is the one who does not put all the eggs in one basket. The role of a state is to provide an appropriate climate for this investment game.

In an underdeveloped economy like that of Nepal, since the domestic source of financing is constrained by an ability to save, investment requirements are fulfilled by an inflow of international fund both private and official. Private international decision to invest is influenced by monetary, credit, fiscal and other policies such as those on profit repatriation, labour use and permissive level and rate of exploitation of available financial and physical resources. Market prospects across the borders is of paramount interest.

The Nepalese Experience

Both the private and public sectors in Nepal are playing important roles in the process of production, consumption, exchange and distribution. Though the size of the private sector in terms of its contribution to GDP is very large (approximately 80 percent) in recent years there has been only a small difference between the size of public and private investment outlays. The public sector, however, is growing over time (Table 1).

TABLE 1: GROSS INVESTMENT AT 1984/85 (2041/42) PRICE INDEX WITH BASE YEAR 1984/85 = 100

	1985/86	1986/87	1987/88
1. Private Sector	85.09	83.16	90.13
Agriculture	100.00	86.63	96.15
Industry	152.78	137.15	148.61
Electricity, gas and water	15.62	15.10	9.62
Construction	104.92	109.72	128.79
Trade, Hotel and Resta.	117.93	121.94	126.63
Transport, Storage and Communication	111.42	68.86	122.84
Fin., Insu., and Real Est.	110.13	119.05	126.96
Commun. Dev. and Social Ser.	114.29	109.52	104.76
2. Other Services (NGOS)	94.55	23.64	23.64
3. Total Private (1 + 2)	85.18	82.60	89.49
4. Government	98.95	101.79	113.92
5. Grand Total	90.51	90.02	98.93

	Share of Government (in percentage)	Share of Private (in percentage)
1984/85	33.66	61.34
1985/86	42.27	57.73
1986/87	43.72	56.28
1987/88	44.52	55.48

Source: CBS 1989
Note: GDP deflator has been used to express figures in real terms.

TABLE 2: DIRECT FOREIGN INVESTMENT IN NEPAL (PERCENTAGE DISTRIBUTION OF INVESTMENT UNDER JOINT VENTURE)*

	Amount (Rs. in Million)	Percentage
Total Investment	1058.736	100.00
1. Industry	797.248	75.30
2. Service	261.488	24.70
Painting (Business Service)	10.701	1.01
Tourism and Hotel	173.716	16.41
Distribution	23.726	2.24
Renting (Apartment)	5.000	0.47
Communication	12.500	0.18
Personal Service	14.973	1.42
Water Turbine	9.300	0.88
Repair	5.757	0.54
Cold Storage	2.317	0.22
Consultancy	3.498	0.33

* Includes ventures currently operational as well as those under construction.
Source: Ministry of Industry (Official File); Date of Issue: September 1988.

Within the private sector fixed investment outlays, while construction, trade, hotel and restaurant, transportation, storage and communication, community development and social service and other service have been recording forward growth trend in the first three years of the Seventh Plan, industry and agriculture have been displaying a backward trend. In view of the large contribution of agriculture and industry to the GDP, to export advantage and to the absorption of the active labour force, the trend of private investment in these two major sectors of the economy is disappointing.

In the meanwhile, direct foreign investment too is not attracted adequately (Table 2). Its share in total national investment in 1987/88 is around nine percent.

Thus, Nepal is very slow in influencing the investment decision of the private sector, particularly in agriculture and industry. In the Seventh Plan it was assumed that private investment would be encouraged via changes through appropriate policies of taxation, licensing, import quota, tariff, wages, subsidies, interest rate, etc. and of public investment outlays in hard and soft infrastructure. The plan also aimed at the supply of other ancillary services like training, banking, communication, insurance, storage, packing, marketing and management. Modern technology was expected to be imposed in the system through the provision of public management of agricultural input and fuel and through budgetary and legal arrangements for the availability of qualified manpower, capital, raw materials and other goods at cheaper prices. The government was also active in exploring external markets for domestic goods and services. The results, however, were disappointing. The next plan must learn many lessons from this failure and the government must take policy conducive to accelerated growth.

Measures To attract Private investment: The basis of future policy choices

The measures to be taken for an accelerated growth of private sector may be classified into: (a) measures affecting only domestic investment; (b) measures affecting only foreign investment; and (c) measures affecting both (a) and (b).

General measures affecting both domestic and foreign investments include policies and programmes which lead to a cheaper supply of: trained manpower, electricity, raw materials and services like banking, insurance, road, storage, communication, packing and forwarding and consultancy. These supplies create external economies in favour of firms, industry and business undertaking and increase the flow of goods and services, a basic requirement of high business turnover. In the meanwhile, climate must be provided for the maintenance of stability in price exchange rate, and tax rate that help reduce uncertainty (as instability in these encourages hoarding, black marketing and control) and for the smooth operation of the capital market providing lubrication to the growth of private industry, commerce, agriculture and other business and linking domestic financial market with the world capital market.

On the other hand, specific measures (in addition to the above) that enhance private domestic investment must provide for adequate arrangement of supply of manpower, marketing mechanisms, raw materials, fuel, machinery and equipment, future security against unfair competition and emergence of monopoly groups as was, lead toward a restriction of capital outflow above a certain limit. Finally, private foreign investment must be encouraged with the specification of: area of operation tax incentives, licencing procedures, rules of profit repatriation, laws regarding nationalization, and protection of property and patent right.

One of the benefits of foreign capital is that it is more likely, than domestic capital, to open up the external markets. Given Nepal's land-lockedness, opening up of external markets will partly depend on solutions of problems of transit. Foreign investment is also conducive to transfer of technology. The limits of foreign capital investment relate to the ruthless exploitation of available domestic resources and, possible, a decay of small enterprises. For overcoming these problems, areas of foreign capital involvement must be identified and antimonopoly act and must be made effective. Conditions related to factory or workshop regulations must be spelled out and legal arrangements for settling disputes must be provided for.

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