# Data Collection and Confirmation Study
# on
# Private Sector Development in Nepal

# FINAL REPORT

March 2013

JAPAN INTERNATIONAL COOPERATION AGENCY

UNICO INTERNATIONAL CORPORATION


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Chapter 7 Infrastructure Development and Other Industrial Location Factors

## Chapter 8 Issues relating to Development of the Private Sector and Strategic Direction

## ABBREVIATION

| | |
|---|---|
| ADB | Asian Development Bank |
| ADSL | Asymmetric Digital Subscriber Line |
| AEC | Agricultural Enterprise Center |
| AN-TUF | All Nepal Trade Union Federation |
| APP | Agricultural Perspective Plan |
| BDS | Business Development Service |
| BIMSTEC | Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation |
| BOT | Build, Operate and Transfer |
| BPO | Business Process Outsourcing |
| C&FA | Carry and Forwarding Agent |
| CEPA | Comprehensive Economic Partnership Agreement |
| CII | Confederation of Indian Industries |
| CME | Census of Manufacturing Establishments |
| CNI | Confederation of Nepalese Industry |
| CPA | Comprehensive Peace Agreement |
| CPI | Consumer Price Index |
| CPN-UML | Communist Party of Nepal Unified Marxist-Leninist |
| CSIDB | Cottage & Small Industry Development Board |
| CTC | Crush Tear Curl |
| CTEVT | Council for Technical Education and Vocational Training |
| DANIDA | Danish International Development Agency |
| DDC | District Development Committee |
| DDF | District Development Fund |
| DFID | Department for International Development |
| DoCSI | Department of Cottage & Small Industry |
| DoFTQC | Department of Food Technology and Quality Control |
| DOI | Department of Industry |
| DoLIDAR | Department of Local Infrastructure Development and Agricultural Roads |
| EIF | Enhanced Integrated Framework |
| EU | European Union |
| F/S | Feasible Study |
| FAN | Floriculture Association Nepal |
| FAO | Food and Agriculture Organization |
| FDI | Foreign Direct Investment |
| FITTA | Foreign Investment and Technology transfer Act |
| FNCCI | Federation of Nepal Chamber of Commerce & Industry |
| FNCSI | Federation of Nepal Cottage and Small Industries |
| GDP | Gross Domestic Product |
| GIS | Geographic Information System |
| GIZ | Deutsche Gesellschaft für Internationale Zusammenarbeit |
| GNI | Gross National Income |
| GSDP | Gross State Domestic Product |
| GSP | Generalized System of Preferences |
| GSTP | Global system of Trade Preferences |
| HACCP | Hazard Analysis and Critical Control Point |
| IAP | Immediate Action Plan |
| IAPEDP | Immediate Action Plan on Economic Development and Prosperity |
| ICT | Information and Communication Technology |
| IEA | Industrial Enterprises Act |
| IFC | International Finance Corporation |
| IFRSs | International Financial Reporting Standards |

| | |
|---|---|
| ILO | International Labour Organisation |
| IMF | International Monetary Fund |
| IPB | Industrial Promotion Board |
| IPP | Independent Power Producer |
| ISO | International Organization for Standardization |
| ISP | Internet Services Provider |
| IT | Information Technology |
| ITC | International Trade Center |
| ITSS | IT Skill Standard |
| JETRO | Japan External Trade Organization |
| JV | Joint Venture |
| KOTRA | Korea Trade-Investment Promotion Agency |
| LDT | Lumbini Development Trust |
| LLDC | Least among Less-Developed Countries |
| MAP | Medicinal and Aromatic Herb |
| MARRADE | Malaysia External Trade Development Corporation |
| MDGs | Millennium Development Goals |
| MEDEP | Micro-Enterprise Development Programme |
| MoA | Ministry of Agricultural Development |
| MoAC | Ministry of Agriculture and Cooperatives |
| MoCS | Ministry of Commerce and Supplies |
| MoI | Ministry of Industry |
| MoTCA | Ministry of Culture, Tourism and Civil Aviation |
| MTEF | Medium Term Expenditure Framework |
| NAC | Nepal Airlines Corporation |
| NBF | Nepal Business Forum |
| NBSM | Nepal Bureau of Standards & Metrology |
| NC | Nepali Congress |
| NCPA | Nepal Coffee Producers Association |
| NDC | National Development Council |
| NEA | Nepal Electricity Authority |
| NEHHPA | Nepal Herbs and Herbal Products Association |
| NEPSE | Nepal Stock Exchange |
| NGO | Non-Governmental Organization |
| NGPTA | Nepal Ginger Producers & Traders Association |
| NIB | Nepal Investment Board |
| NICC | Nepal-India Chamber of Commerce & Industry |
| NITF | Nepal International Trade Fair |
| NPC | National Planning Commission |
| NRB | Nepal Rastra Bank |
| NTA | Nepal Telecommunication Authority |
| NTB | Nepal Tourism Board |
| NTIS | Nepal Trade Integration Strategy |
| NTUCI | Nepal Trade Union Congress Independent |
| ODOP | One District One Product |
| OTOP | One Tambon One Product |
| OVOP | One Village One Product |
| PAN | Permanent Account Number |
| PPP | Purchasing Power Parity |
| PPP | Public Private Partnership |
| PRSP | Poverty Reduction Strategy Paper |
| PTB | Physikalisch-Technische Bundesanstalt |
| SAARC | South Asian Association for Regional Cooperation |

| | |
|---|---|
| SAFTA | South Asian Free Trade Area Agreement |
| SAFTA | South Asia Free Trade Area |
| SAPTA | Agreement on SAARC Preferential trading Arrangement |
| SDC | Swiss Agency for Development and Cooperation |
| SEZ | Special Economic Zone |
| SEZB | Special Economic Zone Board |
| SLC | School Leaving Certificates |
| SME | Small and Medium-sized Enterprise |
| SRCAMP | Shindhuli Road Corridor Agriculture Master Plan |
| SSME | Survey of Small Manufacturing Establishments |
| TEPC | Trade and Export Promotion Center |
| TEVT | Technical Education and Vocational Training |
| TSLC | Technical School Leaving Certificate |
| UNCDF | UN Capital Development Fund |
| UNCTAD | United Nations Conference on Trade and Development |
| UNDP | United Nations Development Programme |
| UP | Uttar Pradesh |
| UPS | Uninterruptible Power Supply |
| USAID | US Agency for International Development |
| VAT | Value Added Tax |
| VDC | Village Development Committee |
| WEF | World Economic Forum |
| Wi-Fi | Wireless Fidelity |
| WTO | World Trade Organization |
| WTTC | World Travel and Tourism Council |

Currency:

US$ 1.0=NPR 85.65

NPR 1.0=JPY 1.09

(2013.2.8.)

# Introduction

# Introduction

## 1. Background

The Federal Democratic Republic of Nepal (Nepal) has been achieving steady economic growth at the annual average rate of around 4% in the past decade, despite political unrest since the 1990s. Nevertheless, its Gross National Income (GNI) per capita is $490 and nominal GDP capita is $642 in 2010, ranked the lowest level in South Asian countries. Furthermore, the country depends heavily on remittance by overseas workers for consumer spending at home. However, remittance-based commercial economy is not sustainable. It is indispensable to plan and analyze the industrial policy with the long-term perspective. This has not been the case in Nepal. Its major challenges are therefore to achieve economic growth through development of local industries, export promotion, and investment growth, while sizable creating employment opportunities within the country. They can be epitomized as the development of the private sector, which then enables sustainable growth of the national economy.

The present Study is designed to seek JICA’s future support policies and opportunities relating to the private sector development. Its primary objective is to collect and analyze basic data and information required to examine, identify, and tabulate major issues relating to development efforts, prospective and priority industries, and possible support schemes, accompanied by proposals to achieve the relevant goals.

## 2. Objective of the Study

The Study is carried out for the following four objectives.

(1) To identify and clarify the present state of the ongoing government programs and projects relating to the development of the private sector in Nepal – in particular, the development of prospective industrial sectors (such as rural industries, MEs and SMEs, processing of agricultural products, and tourism) as well as promotion of trade and investment – together with issues and bottlenecks, by reviewing documents, reports and interview surveys in and outside Nepal.

(2) To carry out capacity assessment of government and other organizations in relation to the development of the private sector.

(3) To identify comparative advantages of the Nepalese economy by taking into account the geographical and other features, to select prospective industries, and to formulate their development strategies and patterns.

(4) To analyze and identify the needs of support relating to the private sector’s development on the basis of the above analyses and assessment, and to propose possible support schemes to JICA.

## 3. Study Area


Figure1 Study Area and Targeted Cities

The Study covers the entire country, including the Terai, hill, mountain and Himalayan regions, with an emphasis on Kathmandu that is the country's economic and political center. In particular, detailed survey was conducted for cities near Kathmandu (including Patan and Baraj), Birgunj that serves as a major gateway to transportation of goods from Kolkata, and urban areas in the Terai region. In addition, field survey was extended to the northern region of India that has close relationship with the Nepalese economy, namely Deli, Uttar Pradesh, and Bihar (see Fig.1).

## 4. Scope of the Study

The Study serves as the preparatory study for JICA's support for the development of the private sector in Nepal by examining relevance of JICA's support, confirming major issues and bottlenecks relating to the development process, and proposing medium- and long term support policies that take into account the country's future growth and prospects. It is thus not carried out under the Scope of Work signed with the Nepalese government and its scope is based on JICA's general work order. The Study covered a wide range of sources, ranging from interview surveys of government and other related organizations in Nepal and private companies operating there, to document review and analysis in Japan, and information gathering via the Internet. Major categories and items of study are listed below.

(1) Current state analysis of macroeconomic environment and other conditions related to the development of the private sector

1) General analysis of macroeconomic trends and policies (government budget, finance, foreign exchange, industry, trade and investment, development of local industries, local economic development, and tourism)
2) Analysis of labor force and its market structure and characteristics
3) Analysis of export, import and investment trends
4) Overall analysis of the country's industrial structure

5) Overall analysis of the financial sector

(2) Current state analysis of the private sector in Nepal
1) Reviewing of past studies and published documents relating to government policies, programs and systems affecting the private sector
2) Analysis of functions, roles and implementation capabilities of government and other organizations (including private business associations) that are involved in the development of the private sector
3) Analysis of special economic zones and their development status
4) Overall analysis of local industries and economies
5) Overall analysis of North India (Deli metropolitan region, Uttar Pradesh, and Bihar)
6) Identification and assortment of major issues relating to the private sector development on the basis of the above analyses

(3) Analysis of bottlenecks and issues relating to the private sector development and determination of JICA's support opportunity in terms of strategic direction
1) Identification of possible development strategies and patterns that can be selected by the Nepalese government
2) Selection and analysis of prospective industries on the basis of comparative advantage, and analysis of their international competitiveness and growth potential
3) Compilation of the results of overall analysis of North India
4) Analysis of bottlenecks relating to industrial promotion (including MEs and SMEs) and promotion of trade and investment
5) Reviewing of support activities undertaken by donor organizations in relation to the private sector development
6) Development of support policies for the Japanese government in terms of strategic direction

(4) Holding a presentation seminar on the study results to major governmental and international institutions.

## 5. Study Schedule

The Study has been conducted according to the following schedule.

Preparatory work in Japan: October 1 – 11, 2012

- The preliminary meeting on study implementation policy and submission of preliminary documents in English

First field survey: October 7 – 21

- Submission of the Inception Report and discussion, presentation to and discussion with related organizations, and implementation of research and study to collect basic data and information

First-phase work in Japan: October 22 – November 6, 2012

- Reporting of the first field survey and results, current state analysis of the private sector and related conditions

Second field survey: November 19 – December 18, 2012

- Continuation of macroeconomic analysis and survey relating to the private sector development

Second-phase work in Japan: December 20, 2012 – January 4, 2013

- Preparation, submission and presentation of the Interim Report, and discussion with JICA in preparation for the third field survey

Third field survey: January 5 – February 3, 2013

- Analysis of bottlenecks and issues relating to the private sector development, determination of JICA’s support policy and opportunity in terms of strategic direction, and discussion with JICA in preparation for the third field survey

Third-phase work in Japan: February 4 – 12, 2013

- Preparation, submission and presentation of the Draft Final Report

Fourth field survey: February 24 – March 3, 2013

- The holding of seminars for the Nepalese government and international donor organizations, and other related parties, and presentation of the Draft Final Report and discussion with Japanese government personnel

Final work in Japan: March 4 – 7, 2013

- Preparation and submission of the Final Report (March 15, 2013)

## 6. Organization of the Report

This report consists of introduction and eight chapters. The first seven chapters present the results of field survey and analysis on key factors, which serve as background information. Finally, Chapter 8 identifies prospective industries and products/services on the basis of the survey results, major issues and bottlenecks, and development scenarios in the form of proposals.

Draft Final Report - Table of Content:

# Summary of Recommendation

# Summary of Recommendation

Chapter 8 of this report covers products with high growth potential, promising investment areas, the direction of the private sector development and the direction of JICA support according to the analysis in Chapter 1 to 7. The following is the summary of recommendation.

## 1. Prospective Industries and Products

The study team has selected 6 products and 4 services on the basis of analysis and assessment of preconditions, production factors, supply and demand conditionsm and growth opportunitiy. Note that they have not selected by weighing relevant factors on equal footing. For instance, some industries and products which production or market is currently small have been selected in consideration of competitiveness or growth potential to become a major export item or an economic base for the country. The final selection criteria are “industries and products that have competitiveness and/or contribute to the building of the country’s industrial structure (foundation).”

Table S-1 Prospective Products and Services Selected by the Study Team

| Role in Private Sector Development | Selected Products and Services |
|---|---|
| I. Industries and products that have competitiveness | |
| • Exportable products which are using an advantage of difference of the tariff rate between India and Nepal | (1) Galvanized steel plates, (2) Instant Noodle |
| • Having an advantage in Nepal such as plenty of resources high quality materials, traditional high skill etc. | (3) Agro and Agro-processing products, (4) Herbal products, (5) Cement, (6) Hydro and Solar energy |
| II. Contribute to the building of the country’s industrial structure | |
| • Products and service area to be developed for the future of Nepal’s industry | (7) IT/BPO services, (8) Light industry products |
| • Products and service area to be contributed to local economic development | (9) Tourism services, (10) OVOP products |

Source: JICA Study Team

Note that some products are identified as product groups consisting of a variety of individual products, namely agricultural/processed products, herb products, and OVOP products. Similarly, industries have been selected as industrial clusters that contain a variety of business activities and services, i.e., power generation, IT/BPO service, and tourism. Thus, industries and products included in these clusters and groups are added up to a sizable number.

## 2. Prospective Fields for Investment

In terms of investment potential and opportunity, the above industries and products/services are considered as prospective fields. They are rearranged according to corresponding industrial sectors as follows.

- Electricity sector
- Agricultural sector
- Light industry sector
- Tourism sector
- ICT industry sector

A high investment prospect for the electricity sector is evident from the present electricity supply condition in the country. Despite abundant water resources, the sector currently generates and supply electricity that falls far below demand. Investment opportunity exists for not only large hydropower plants but small-scale plants and photovoltaic cell power generation. Although the government, led by the Nepal Investment Board, is soliciting investment, terms and conditions are not clear in a number of areas, including tax and other incentives for investors, sales of generated electricity, and remittance of profits by foreign companies to home countries. The government should urgently establish legal and other systems and institutions to promote investment in the electricity sector.

As for the agricultural sector, prospective products have been selected in consideration of exportability and marketability. The country's natural environmental conditions, in positive aspects, make cultivation of vegetables, fruits and floricultural products highly prospective. In fact, interest in the export-oriented agricultural sector is expressed by companies in China, Israel and Georgia. Indian companies are investing in herb production. On the other hand, there is a supply shortage of staple food – cereals – in the country, and investment opportunity exists for rice and wheat production. It should be noted, however, that, to make agricultural products in amounts sufficient for exports by attracting investment, it is imperative to allow large-scale farming by reforming a legal system, for example a reform making it possible to convert forest areas to farmland (currently all mountain areas are regarded as forest areas even if no trees are there.).

As for the manufacturing sector, investment opportunity is basically found in the light industry sector. In light of the fact that Nepal has still to establish a firm industrial base and has to rely on imported materials, together with a weak technological base in terms of width and depth, it would be safer to promote relatively small investment projects - including foreign direct investment –in the light industry, such as food processing, MAPs processing, textiles and metalworking. Furthermore, foreign companies need to be fully committed to investment in Nepal by not only bringing capital and technology but also providing marketing channels (in case of export) and technical support relating to human resource development.

On the other hand, as for automobile and other large-scale industries, it is less likely that some visible development occurs in a short term. Investment attraction for these sectors appears to be feasible in the strategic context that looks for the Indian market. In India, automotive production is expected to increase from 3.1 million units in 2011 to around 10 million by 2020. To meet the forecast, it is important for assemble plants in India to attract suppliers, including Japanese ones. Investment in Nepal can be expected in this context and thus depends on the automotive production trend in India or Pakistan, although there are a lot of hurdles for Nepal to clear before promoting foreign investment.

As for the tourism sector, a prospective area for investment is found in the development of tourist resources, rather than hotels and restaurants, because the country has not made full use of natural resources, including the Himalayas and the national parks. In particular, combination of green tourism (agro tourism) using local resources including agricultural resources with existing tourism can create new tourist attractions. Also, in addition to Nepal's traditional tourist resources based on natural sceneries and cultural heritages, investment opportunity seems to exist for development of tourist attractions not affected by season or weather, creation of family tour routes, and long stay type tourism that incorporate health care and educational elements, which can target local people as well as foreign tourists.

As for the ICT industry sector, investment projects using the country's young workforce in the software development and BPO fields are feasible. Already, three Japanese companies have made investment. It is desirable to start with a small project and build up the customer's confidence gradually, followed by expansion. The government has announced policy to promote investment in this area and is expected to increase incentives for foreign companies if the announced programs are implemented. In particular, the upgrading of the IT Park in Banepa to accommodate foreign companies will serve as a great advantage in comparison to other sectors for which industrial estates suitable for foreign investors are not available.

To successfully promote foreign investment in the above sectors, the improvement of the investment climate is essential in addition to the incentives focusing on a specific sector. It can be achieved by the government's committed efforts on two fronts, namely administrative capacity building and deregulation. At the same time, the enforcement of business laws and regulations can serve to warrant that related policies and programs are formalized, thus helping gain confidence of investors. Finally, efforts to minimize the political risk (cost), including visualization of the policymaking process, are directly linked to the improvement of the general business environment in the country.

## 3. Significance of the Private Sector's Development and Goal Setting

Since 2006, the Nepalese government has been consistently setting the primary goal of economic development as "poverty alleviation and correction of regional inequality." For instance, as discussed in Chapter 2, the ongoing three-year development plan (2009/10 – 2012/13) sets forth the development goal as follows.

"The goal of the plan is to improve living standards of all Nepalese people, reduce poverty, and achieve the MDGs by 2015 through sustainable economic growth, more concretely, generating employment opportunities, reducing economic inequalities, achieving regional balances, and eliminating social exclusions."

At the same time, the Japanese government set the following goals (as of December 2012) for official assistance in Nepal's development and undertook activities in a variety of fields.

Overall goal (basic policy)

To assist the country in promoting consistent and sustainable economic growth with an aim to grow out of the LLDC status.

Intermediate goals (immediate priorities)

(1) Poverty reduction in rural areas
⇒Upgrading and diversification of agricultural activities and products for higher value addition and the improvement of income generating opportunity through local processing of agricultural products
(2) The establishment and maintenance of the peace and a steady transition to democracy
⇒To support a further progress of the democratization process
(3) Development of the social environment and foundation to ensure sustainable and balanced economic growth
⇒To provide support in relation to infrastructure development including power supply.

On the basis of the development policies announced by the two governments, the present Study is designed to find desirable directions of the private sector's development. In this connection, however, it should be pointed out that poverty reduction cannot constitute a direct goal relating to the private sector's development, while it can be set forth as an overall goal for national economic development. Thus the Study sets the primary goal in relation to the development of the private sector as "the achievement of sustainable and balanced economic growth." Under the setting, the following three intermediate goals are established, followed by the setting of a strategic direction toward the accomplishment of them.

The primary goal of the private sector's development is
"To achieve sustainable and balanced economic growth"

Intermediate goals:

1) To build up the industrial base that serves as an engine for sustainable economic development;

2) To promote trade and investment with an emphasis on the establishment of the "Made in Nepal" brand; and
3) To revitalize local economy by using locally available resources.

These goals, both the primary one and intermediate ones, are ultimate goals in the private sector development in Nepal. Achieving intermediate goals lead to achieving the primary goals. That is, intermediate goals are direct goals in the private sector development, and the primary goal is achieved as a result of achieving the intermediate ones.

The first intermediate goal, to build the industrial base, does not target the manufacturing sector only. All industrial sectors whose base is not solid are targeted. Second one, to establish the "Made in Nepal" brand aims for trying to meet international quality and be competitive against imports from the beginning, instead of settling for lower quality which is yet acceptable in the domestic market. Third one is about the development of local economy which has various constraints as well as many regional resources. As already said, achieving each of the intermediate goals lead to achieving the primary goal.

In particular, the private sector's development in Nepal needs to be worked out from perspective of balanced industrial promotion in terms of geographical distribution to benefit the whole country including hilly and mountainous regions, not to mention a conventional approach focusing on the buildup of the industrial base and trade and investment promotion.

## 4. Recommended measures for trade promotion

(1) Formulation of product-specific export promotion strategy

Nepal has already set forth broad strategies for export promotion, including analysis of the current state, in "Trade Policy 2009" and "Nepal Trade Integration Strategy 2010 (NTIS)." Unfortunately, however, they have not been translated to specific action plans. For instance, Trade Policy 2009 specifies 13 working policies but fails to propose schemes to implement them. Similarly, NITS stops at analysis of exportable items, identification of issues, and proposition of action items, not going into specific measures to be undertaken. The MoCS, which has formulated these strategies, seems to present them to other ministries, the private sector and international donor organizations in the hope that they take a lead in implementing them and/or provide necessary support and assistance. This is a typical example of the failed working of policies and programs, which is attributable not only to budget constraint but also to the disregard for enforceability of broad policies, which has resulted in the lack of consistency and integrity with related policies and programs.

A strategic export promotion approach means the formulation of export promotion plans that are expressed by "5W1H," i.e., specific actions, methodology, resources, and time schedule.

The most important export strategy for the country is to create a champion product that serves as a model case to follow. For instance, the government is striving to promote pashmina products by having “Chyangra Pashmina” registered as a collective trademark in various countries. Clearly, trademark registration alone is not sufficient. To develop pashmina to a champion product among Nepal’s export items, it is essential to develop and implement an export promotion strategy that works well in the global market. For instance, the country’s present supply capacity cannot meet the needs of the world pashmina market, which overshadows the high quality and low price advantages. The small amount of exports does not help increase recognition in the world market. The similar conditions are found in relation to other items having high export potential. The export promotion strategy should represents the country’s committed efforts to develop a champion products, which should include integration of the production process, technical support for selection and processing of raw materials, product inspection, and effective promotion and advertisement in foreign markets. It is therefore recommended to conduct detailed market survey for products with export potential, whose results will form the basis of developing an effective export promotion strategy.

(2) Capacity building for the public supporting institution

The government’s trade promotion system has various weaknesses. In particular, the Trade and Export Promotion Center, which was established to accelerate the country’s export policy efforts, fails to serve as a prime engine for trade promotion. Clearly it is essential to define a primary role and function of TEPC together with increasing the manpower and budget. The major challenge for export companies in Nepal (or development of export products) is to satisfy international quality standards. Many companies complain about low levels of technology, insufficient equipment, and low quality of raw materials, but they have to learn the ways to overcome the problems by making innovative efforts, while knowing the actual needs of the foreign markets. In so doing, adequate information should be collected and provided by a public organization, which is a primary role expected to be played by TEPC. At present, it provides only information on Nepal. TEPC should go back to the starting point and needs to build up capacity required to fulfill its original role and function (as for development of networks, see (3) below).

(3) Accelerated building of networks to collect foreign market information

As discussed earlier, the lack of useful information on foreign markets and buyers constitutes a major bottleneck for Nepal’s export promotion. Many products exported from Nepal are made on a contract basis and according to customer’s specifications. It is far from exports on the basis of an elaborate strategy to satisfy the needs of specific markets by in-depth market survey. Today, leading buyers in industrialized countries evaluate product proposals by suppliers prior to the competitive bidding for contract manufacturing. Also, smaller buyers search for good suppliers all over the world by using various information sources, such as trade promotion organizations (JETRO of Japan, KOTRA of South Korea, MATRADE of Malaysia, and chambers of commerce and industry and trade representative offices of Europe and the U.S). This means Nepalese export companies are expected to have the ability to explore market opportunities by offering attractive product proposals. What the country needs at first is a formal organization and mechanism to collect and supply foreign market information that leads to the development of products that impress foreign buyers.

It is therefore important to build up information networks by strengthening cooperation with foreign trade promotion organizations and chambers of commerce and industry, while using international organizations and their resources, such as UNCTAD's Trade Point and the International Trade Center (ITC). Also, Fair Trade Organization's Nepal office is considered to be a useful information source. Women's Skills Development Organization in Pokhara has learned the needs of foreign markets and has successfully found buyers through effective promotional activity. This serves as a model case to be followed by many companies.

(4) Promotion of "Made in Nepal" brand

The establishment of a national brand is a major challenge for export promotion by any country. As Nepalese companies mostly export their products in response to orders by foreign buyers, leading export items, such as tea and pashmina, are not widely recognized in the international market. Only one brand widely known in foreign market is "Wai Wai" for instant noodles. At present, efforts are being made to have pashmina registered as a trademark on a global scale. Similar opportunities seem to be available for several other products, including orthodox tea and organic coffee. In doing so, the government is expected to provide auxiliary support, including foreign registration of trademarks, participation in international trade shows, and crackdown on imitations sold in and outside the country (including those sold at souvenir shops), which would help reinforce market confidence on Nepalese products as a whole.

(5) Promotion of exports to India and China

Nepal's geographical position bordering India and China means massive market opportunities within easy reach. However, this advantage has not been utilized effectively, and instead, it has resulted in high dependency on imports from the two countries. Clearly, the country and its industry cannot directly compete with these colossal economies. Instead, efforts should be made to use the tariff differentials with these countries and explore niche markets not covered their industries. Such efforts vary in size, ranging from a sizable project to small improvements.

For instance, the lack of standardization is considered to be a major factor to prevent Nepal's agricultural products from being marketed in India's distribution channels. While the achievement of uniform quality including taste may take some time, size standardization can be accomplished by economical efforts within a short period of time. Also, proper washing and packaging of products, including the standardization of shipment units, can be largely dealt with by small efforts in the field, rather than sizable investment. Also, the government can play a leadership role in development of uniform systems and standards, the streamlining of inspection and other procedures, and information service via the Internet.

## 5. Recommended measures for investment promotion

(1) Formulation of strategic investment promotion plans

As seen in export promotion, the government does not have strategic action plans for investment promotion. For instance, the government and other organizations have already listed prospective industries and products for export and investment, without waiting for the Study. Unfortunately, however, they do not have an effective strategy to link the prospective industries and products with realistic investment promotion measures. For instance, although a negative list showing fields not open to foreign investment exists, there is no list presenting those that welcome foreign investment[1]. Also, incentives for investment in priority areas are not distinctively different from those offered for other areas.

Investment promotion activity should differ in a manner of approaching potential investors between infrastructure and other large-scale projects and those relating to the development of private sector, such as light industries, tourism, and information service. While investment promotion activity is not undertaken at significant level, the government should have strategic investment promotion plans that focus on specific sectors, especially light industries, tourism and IT industry.

(2) Upgrading and strengthening of public relations and promotional activities relating to investment promotion

The lack of effective information promotion activity is inevitably accompanied by the lack of investment information on Nepal available to potential investors, not to mention a limited means of publicizing information. At present, the Confederation of Nepalese Industries (CNI) is developing the portal site “Invest Nepal” in cooperation of the MoI and under assistance of USAID. It is considered to be very useful for foreign investors by providing comprehensive information on Nepal’s business environment and industries in English, including investment-related procedures and regulations. However, a question should be asked to the Nepalese government: Why is this type of information service provided by CNI, a private organization? It is highly desirable to provide information service and consultation for potential investors by the same organization.

Information service provided for the purpose of investment promotion is mainly targeted at India, while little investment promotion activity, including transmittal of information, has been carried out for other countries and regions. Nevertheless, the largest number of

1 Investment Board Act 2010 lists investment projects under IB’s jurisdiction, which are mainly concerned with large-scale projects, such as infrastructure (such as airports, roads, railroads, waste treatment facilities, bridges, and hydropower plants), fertilizer plants, petroleum refineries, and hospitals with 300 or more beds. On the other hand, the DoI’s negative list bars foreign investment in real estate, small industries (including retailers) and the manufacturing of fire arms.

applications for foreign investment projects comes from China in the past five years, and applications by Korean companies are on the rise. Thus, promotional activities targeting countries other than India, on the basis of an elaborate strategy to make an effective appeal to each country and its industries, are expected to contribute significantly to the development of the private sector in Nepal. Thus, on the basis of investment promotion plans formulated as recommended in (1) above, efforts should be made to redefine and upgrade investment promotion activity for each of the countries selected as major targets, including methodology used for information dissemination, advertisement and promotion.

(3) Investment promotion targeting local investors

Investment promotion activity, while not being conducted aggressively, has largely targeted foreign investors. However, the government's promotional efforts should try to explore as many investment projects as possible, which include local companies (including joint ventures) and entrepreneurs. They could also lead to vitalization of local industries. Investment decisions are made by investors and the role of the government is to create an enabling environment. However, the government can establish standards and rules to be complied with by local investors in parallel with providing incentives, thereby to help improve competitiveness of local industries and create synergetic effects with other policies such as regional development.

Finally, promotion activity targeting local investors needs to be combined with public support relating to financing, land development, and marketing, in addition to investment seminars to disseminate useful investment information. For example, investment promotion should be packaged with the establishment of a startup loan program, nationwide deployment of business incubation service, and the establishment of industrial estates specialized in cottage and small industries, and the construction of an agricultural product processing and distribution center.

(4) Restructuring of the investment promotion system

The Nepalese government's investment related service is provided by the IB and the DoI, depending on the amount of investment (with the border line at Rs.10 billion). Note that service provided by the two organizations is limited to consultation and investment approval procedures, whereas there is no organization responsible for implementation of investment promotion activity. While there seems to be a tacit understanding on the government side that the IB and the DoI are also responsible for investment promotion, neither of them has human resources or the budget to conduct promotional activity. This explains why CNI, a private organization, undertakes investment promotion activities, including the development of an information portal site for potential investors.

Under these circumstances, priority should be given to the restructuring of the investment promotion system led by the government because the country needs to formulate and implement investment promotion plans under the leadership of a government organization having legal authority. Under the present system, investment projects demanded for the purpose of developing the private sector are generally not under the jurisdiction of the IB, while the DoI that should handle them fail to conduct investment promotion activity. If investment is to be positioned as a national policy priority, the investment promotion system should be reshuffled to ensure effective and sustainable implementation of investment promotion efforts under the unified leadership, e.g., concentration of power and authority in the IB so that it becomes responsible for investment promotion targeting both local and foreign investors regardless of project size.

## 6. Strategic Direction for Vitalization of Local Economy

(1) Road construction as infrastructure to drive industrial development in rural areas

There are a correlation between the number of enterprises and the availability of paved road. That is, there are fewer enterprises in areas where the paved road network has not developed. Clearly, poor access to transport caused by bad road conditions impedes development of tourist resources in the far-western, western and Himalaya regions, which would otherwise provide a precious investment opportunities for these regions. For example, the area around the lake Chhubhal in the Far West region has high potential as a tourist site, but the development of road and flight connection is delayed.

In other words, infrastructure development, especially road construction, is the prerequisite to the development of rural industries including tourism. Although voices are raised to demand construction of local airports to establish a transportation route over rough terrains widely seen in the country, access roads must be constructed to link an airport with surrounding communities if air transport service is to be used as the springboard for rural development. In this connection, it is encouraging to see that some road construction projects are implemented under the PPP model. To accelerate the pace of industrial development in rural areas, road construction must be made by using available resources including partnership with the private sector and other organizations.

(2) Fostering of local leadership for industrial development in rural areas

Rural industrial development, be it the type to use local resources or the one to attract a new industry, should be planned and implemented under a strong local initiative and leadership. In doing so, local leaders play an essential role in generating an original idea that leads to a development project by sharing it among local stakeholders. At present, however, there are few persons who are capable of serving as a true leader because many of the existing leaders are accustomed to follow the lead of the central government and its development programs. A primary example is seen in the OVOP movement that was conducted for five years, starting in July 2006. As it was launched as a top-down, government-led development project, local people participated without a strong commitment and carried out activities planned and directed by the government, without contributing their own ideas. Although some leaders and staff members of FNCCI's district offices feel the need for local initiative and leadership, there is no formal mechanism to take it up at the central government level or no attempt to disseminate or discuss possibility of spontaneous development at the local level.

At present, there is a serious shortage of human resource, goods, and money that can be allocated to rural development efforts and the fostering of local leaders is not an easy task. Nevertheless, some moves are already made in several areas[2] and local leaders are emerging. To ride on the waves, it is important to provide government support for the establishment of a full-fledged local initiative and leadership and to advertise the successful attempts as a model case to be followed by other areas. Also, the government needs to build up a formal system to allow local leaders to train and nurture leaders in other areas. In this connection, the new OVOP movement as proposed later can be used as a mechanism to empower the fostering of local leadership. Leaders in Dolakha and Kaski attended JICA training in Japan on OVOP, and put in practice what they learnt. Active learning from oversea cases like this is necessary.

(3) Development of a nationwide physical distribution system

In the landlocked country with geographical features to prevent smooth distribution of goods, the lack of a physical distribution system is a major issue facing rural industrial development; it is particularly problematic in the mountain, hill and Himalaya regions. The issue is not only relating to a high distribution cost but also poor or even absence of market access that adversely affects rural economy and its development. Furthermore, poor market access means the lack of market information for producers in rural areas. Even if there are roads connected to a rural area, poor surface conditions often cause product loss or damage on the way to the market. Thus, development of a nationwide physical distribution system is a critical factor for successful development of rural industries. The Shinzuri Road Construction Project and its related project to develop a master plan for dissemination and promotion of higher value added agriculture in areas along the Shinzuri Road (SRCAMP), implemented under JICA's assistance, are considered as a model cases toward the goal. In particular, high value added agricultural products and an agri-business model proposed as part of SRCAMP, which take into account local conditions, seem to be applicable to other areas in terms of a new approach adaptable to the entire country. The projects suggest the need for development of a physical distribution system that meets the needs of local industries and products in a specific area.

(4) Redesigning and re-launching of the OVOP initiative

The original OVOP movement that was carried out for the past five years was characterized as an agricultural development program using government subsidy, which significantly deviated from the true OVOP concept. There seem to be several reasons for this.

[2] Including Dolakha, Nuwakot, and Kaski.

Firstly, the program did not accompany sufficient training for human resources (local leaders), which would serve as a driving force. Secondly, the program focus was placed on expansion of agricultural production, rather than vitalization of local community and economy. Local people seem to have viewed the OVOP as a subsidy program and to have participated without a sense of spontaneity and ownership. Thirdly and finally, the OVOP movement lacked a basic principle in the OVOP movement in Oita in Japan and in Thailand, "Think globally, Act locally."

At present, a plan to continue the OVOP under a different title (ODOP : one district one product) is under consideration. FNCCI's district offices have already listed products and services that they want to promote under the ODOP program. The list differs from the one for the previous OVOP program in that it includes Buddhist tourism, handicraft products, and special economic zones. It can be seen as an industrial promotion measures applying the OVOP movement. It is closer to the original OVOP movement in that these products and services have been selected under local initiative, but no detailed plans have been established as to the actual deployment of the program as a bottom-up movement. Besides, as the previous OVOP program was led by the MoA, somo of those who have been involved in it wonder if selecting non-agricultural products or services is appropriate for the ODOP program. Although it is not clear as to how the program will be deployed until its actual launching, the program should be used to vitalize local community and economy, not just to develop and market specialty products in rural areas. Furthermore, its starting point is the training of local leaders and the empowerment of local initiative and ownership.

## 7. Desirable Direction for JICA's Support

Finally, a desirable direction for assistance and support by the JICA is examined. Note that the following support schemes are proposed for the purpose of promoting the development of the private sector in Nepal, not necessarily targeting specific industries, so that they are designed to address the challenges and issues commonly seen in various industries and products. The proposals mainly take up the schemes that are classified according to the four key target areas, namely: (1) trade/investment promotion; (2) development of microenterprises and SMEs; (3) development of local industries and vitalization of local economy; and (4) development of tourism and ICT industry. Then, each support scheme contains any of the following six components.

- Capacity building and human resource development
- Development of related legal systems and institutions
- Upgrading of technological capability
- Market development/physical distribution
- Financial service
- Regional development

Note that, this report identifies and analyzes the three major issues that have large impacts on the private sector's development, namely "electricity shortage," "poor road infrastructure," and "political instability." JICA has already assisted democratization and peacekeeping together with other donor institutions. JICA has also been conducting programs to address electricity shortage and poor road infrastructure. Assuming that support programs to improve electricity supply and road conditions will continue to be carried out by JICA and other donor organizations, together with the Nepalese government, at an accelerated pace, these issues are not addressed in the support schemes proposed herein.

Finally, the support schemes proposed below are presented as necessary measures and actions to be undertaken for the development of the private sector in Nepal, not necessarily indicating that they are to be implemented under assistance or support of the Japanese government. In fact, some of them are already implemented as part of programs initiated by the Nepalese government and/or other donor organizations, so that it is desirable to formulate implementation plans, including methodology, after coordination to avoid duplication of efforts.

## 8. Proposed Support Schemes and Outlines for Development

For each of the four target areas for development, the Study proposes the following support schemes.

(1) Trade/investment promotion

Here, common measures for trade and investment promotion are presented in a cross-sectional way. OVOP and local specialties are among support targets.

| Support scheme | Outline |
|---|---|
| 1) Support for development of product-specific export promotion strategy | To conduct market study and develop export promotion plans for product items that show high export potential. |
| 2) Reinforcement of TEPC's organization/capacity building | To reinforce organizational strength of TEPC as the trade promotion organization and to improve administrative capability of staff members. |
| 3) Traveling exhibition programs using permanent exhibition facilities in foreign countries | To hold traveling exhibitions to advertise Nepal's high-grade products at permanent exhibition facilities provided by Japan and other industrialized countries (including local governments) for products made in developing countries. |
| 4) Business matching service using foreign trade promotion organizations, the chamber of commerce and industry, and other related organizations | To use market information stored by foreign trade promotion organizations, the chamber of commerce and industry, and other related organizations for export promotion by Nepalese companies (matching service between companies and markets) |
| 5) Implementation of the "Made in Nepal" campaign | To carry out series of export promotion campaigns for Nepalese products by using a variety of media (including the ongoing strategy focusing on international trademark registration). |
| 6) Support for formulation of strategic investment promotion plans | To help formulate strategic investment promotion plans that are effectively linked with the national industrial development and export promotion policies. |
| 7) Reinforcement of organization/capacity building for investment promotion organizations | To restructure the present promotion system by redesigning and strengthening the function and role of IB and DoI to allow implementation of strategic promotion plans. |

| Support scheme | Outline |
| --- | --- |
| 8) Amendment of the Investment Board Act and redesigning of incentives | To amend the act and redesign incentives for investors according to the new strategic investment promotion plans. |
| 9) Support for productivity improvement of export-oriented companies | To implement a productivity improvement program for export-oriented manufacturers, mainly consisting of factory diagnosis and field guidance. |

## (2) Development of micro enterprises/SMEs

| Support schemes | Outline |
| --- | --- |
| 1) Rural deployment of business incubation service | To establish BICs in major cities in other regions than Kathmandu (only one BIC at present). |
| 2) Reinforcement of organization/capacity building for BDS providers | To promote capacity building of local BDSs, including FNCCI. |
| 3) Launching of a startup support fund (seed money) program | To upgrade the MoI's SME Fund (grant) to a new financial support program for startup business that provides low interest loans. |
| 4) Two-step loan program for export-oriented SMEs | To establish a loan program to assist export-oriented SMEs (with the export ratio of over 35%) in renewal and upgrading of production equipment. |
| 5) Establishment of FNCCI's credit guarantee program | To establish a credit guarantee system that is operated by FNCCI in collaboration with the MoF and local financial institutions, with an aim to alleviate collateral requirements for borrowers. This program will include a training program for borrowing companies to teach credit management and related knowledge. |
| 6) Restructuring of organizations in charge of promotion of cottage and small industries | To reorganize the DoCSI and CSIDB. |

## (3) Development of local industries/vitalization of local economy

| Support scheme | Outline |
| --- | --- |
| 1) Development of a physical distribution system in rural areas | o formulate plans for development of a nationwide physical distribution system (including shipment, storage, selection, and packaging) for local products, especially agricultural products, by dividing the country into 10-12 zones, and to build facilities and provide equipment in each zone. |
| 2) Support of the OVOP movement | To launch a new OVOP initiative with the primary purpose of vitalizing local economy and community, which integrates activities relating to the development and promotion of a specialty product in each locality. |
| 3) Support for projects to promote joint operation and establish collective facilities | To help install collective facilities for local farms, including selection, cleaning and storage facilities. Note that various instruments and arrangements used for the previous OVOP movement will be used where applicable. |
| 4) Program for upgrading of design and packaging technology | To provide technical assistance and guidance for packaging and design relating to locally produced agricultural products. |
| 5) Collaboration with Fair Trade Organization | To implement an export promotion program for local products by using Fair Trade Organization's networks in and outside of the country. |

(4) Development of tourism/ICT industry

| Support scheme | Outline |
|---|---|
| 1) Formulation of a development master plan for Buddhist tourism | To formulate a development plan for Buddhist tourism sites in Lumbini and Kaplivastu, together with those in North India (for Lumbini, an existing development plan will form the basis of the new development plan). |
| 2) Promotion of agro-tourism development | To promote nationwide development of agro-tourism using local resources and tourist attractions and to provide technical advice where possible. |
| 3) Technical advice on tourism promotion activity in foreign countries | To provide technical advice on methodology to encourage rediscovery of tourist attractions in Nepal and advertise them to foreign tourist agencies and tourists in an effective manner. |
| 4) Formulation of revitalization plans for the Banepa IT Park and attraction of investors | To develop plans to revitalize and upgrade the IT Park in Banepa and to attract companies. |
| 5) Introduction of IT skill standard (ITSS) | To provide support for development and implementation of plans to introduce ITSS in Nepal by using India's experience as a model case. |

The four components listed in a cross-sectional way broadly target all geographical area of Nepal, and yet the direction of support can be divided into "trade and investment promotion in the Terai" and "economic revitalization of hilly and mountain areas". That is, the two directions serve as two pillars of the private sector development in Nepal.

(5) Beneficiary (counterpart) organizations

Beneficiary (counterpart) organizations for the above support schemes are listed below (for acronyms for some organizations, see the list shown at the beginning of the report).

Table S-2 Beneficiary Organizations of Support Schemes

| | Capacity Building & HR | Legal system and institutions | Technological Capability | Market Development | Financing | Regional Development |
|---|---|---|---|---|---|---|
| Trade/Investment Development | IB, DoI, TEPC, CNI | MoI, MoCS, | TEPC,CNI | FNCCI,Local brokers, local CCI | RSB, Local banks | FNCCI,FNCSI |
| SME Development | DoCSI/ CSIDB, local CCI | MoI | FNCCI's Association/ local CCI | FNCCI's Association/ local CCI | FNCCI、Local banks | DoCSI/ CSIDB |
| Local industries | AEC/FNCCI/ MoA/local CCI | MoI | Local producers、DoFTQC, local CCI | FNCCI、FNCSI, local CCI | Local producers | DoCSI/ CSIDB |
| Tourism/ICT | NTB, LDT, local CCI | MoTCA | Local tourist agents, Guides | LDT | Local tourist agents | LDT、FNCCI |

# Chapter 1 Socioeconomic Conditions in Nepal

# Chapter 1 Socioeconomic Conditions in Nepal

## 1.1 General Background

### 1.1.1 Current Status

(1) Geography and population

The Federal Democratic Republic of Nepal is an inland nation situated between China (Tibet Autonomous Region) and India. It has a land area of around 147,000km$^2$ (36% of the land area of Japan) and has multiracial population of around 26.5 million[1], consisting of over 100 ethnic groups. In addition to Nepalese as the national language, more than 90 languages are used. Demographically, the population is young with the 25-year or younger age group accounting for over 55% of the total[2]. The land is roughly divided into three regions: the Himalaya region on the north (with the altitude of more than 4,000m), where 6,000 – 8,000 m mountains rise; the Terai on the south (with the latitude of 300mm or less), which is a high-temperature, highly humid plain that extends along the border with India; and 300 – 4,000 m hilly and mountainous areas in the middle. Relative to the land area, Nepal has very diverse geographical features and natural environments. Around 50% of the population resides in the Terai, 43% in the hill area, and 7% in the Himalaya region. Industrial and economic activities are concentrated in the Terai, Kathmandu and surrounding area, while sparsely seen in the Himalaya and other mountain areas where infrastructure has not been developed due to geographical restrictions

(2) Political trend

Nepal had been under the imperial rule for over 200 years until the mid-1990s. In February 1996, however, longstanding discontent with the monarchy system and rent seeking by the privileged classes eventually led to an outbreak of armed conflicts, which lasted for the ensuing ten years. Backed up with the popular support, Maoist started to raise the violent struggle to substitute the monarchy with democratic republic system.

In November 2006, the Comprehensive Peace Agreement (CPA) ended the civil war to start a peaceful process of building a new country. At the Constituent Assembly election held in April 2008, the Communist Party of Nepal (Maoist) became the majority party, and the Constituent Assembly in May of the same year decided to abolish the monarchy system which was considered to be a cause for the turmoil, and to change over to the federal republic system. Since then, the Federal Democratic Republic of Nepal is in the process of peacemaking and

[1] According to the National Population and Housing Census 2011, the official count of population is 26,494,505.
[2] As od 2012, around 3.5 million Nepalis work abroad.

democratization, which is still far from completion as too many political parties[3] prevent consensus on the enactment of a new constitution and political and other reforms.

The present Bhattarai administration, inaugurated on August 29, 2011, is no exception. In addition to the unresolved issues including the establishment of the constitution, integration of Maoist Militants into the national military forces, and autonomy of federal states, political frictions between various parties, which have been persisting since the 1990s, prevent the administration from exerting a strong political leadership, and keeps the government in disarray. For instance, the government budget for fiscal year 2012/13[4] had been executed in July 2012 as provisional one covering only the first four months and it was not until November 2012 that the budget for the remaining eight months was compiled[5]. In response to anomalous conditions, 15 parties including Nepali Congress and Communist Party of Nepal (Unified Marxist-Leninist) staged protest demonstrations from November 17 to December 15, 2012 to demand an advanced holding of the Constituent Assembly election. Although the Bhattarai administration has announced to hold the election in around mid-June 2013[6], the political situation is still unstable and uncertain, including the survival of the present administration. During the field survey, the study team kept hearing from Nepalese private sector as well as business organizations in India that the present political unrest made the government dysfunctional, which in turn disturbed the development of the national economy. For the country to develop the economy, therefore, it is imperative to regain political stability under strong leadership, more than anything else.

Note that the diplomatic relationship between Nepal and Japan was established in September 1956.

(3) General socioeconomic trends

In the fiscal year 2010/11, Nepal's nominal GDP was approximately US$18,540 million and GDP per capita was $642. As more than 55% of the population lives at less than $1.25 per day, the United Nations classifies Nepal as a least less-developed country (LLDC)[7]. According to the UN's human development index, Nepal ranks 157th among 187 countries (as of 2011), more less than Pakistan (145th) and Bangladesh (146th). As seen in other South Asian countries, Nepal receives a large amount of money from overseas workers, which significantly

[3] As of January 2013, there are more than 20 parties, of which the opposition parties amount to 19. Moreover, it is difficult to form an agreement among the three major parties (UNCP (Maoist), Nepali Congress (NC), and Communist Party of Nepal (Unified Marxist-Leninist) (CPN-UML). Note that more political parties are registered with the Election Commission, including those which political views are not clear.

[4] Nepal's official calendar (Bikram Sambat) starts in mid-April, and the fiscal year runs from mid-July to mid-July. Fiscal 2010/11 started on July 17 and ended on July 16.

[5] On November 20, 2012, it was announced to allocate Rs.351.93 billion as the budget covering the remaining eight months.

[6] As of January, 2013 at the time of research, it was still uncertain if this commitment would be implemented by the deadline.

[7] The percentage of the poor in Nepal is higher than Bangladesh (49.6%) and India (41.6%) and is considered to be at the highest level among the SAARC countries.

bolsters the country's household income[8], indicating that its local industry cannot act as a sole driving force that moves the country out of the hovering economic conditions.

Table 1.1-1 Percentage of FDI per GDP in South Asia

(Unit : %)

| | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| Bangladesh | 1.3 | 0.8 | 0.9 | 0.7 |
| India | 3.5 | 2.6 | 1.6 | 1.7 |
| Pakistan | 3.3 | 1.4 | 1.1 | 0.6 |
| Sri Lanka | 1.8 | 1.0 | 1.0 | 1.6 |
| Nepal | 0.0 | 0.3 | 0.5 | 0.5 |

Source：World Bank, Foreign Direct Investment, New Flow (% of GDP)
http://data.worldbank.org/indicator/BX.KLT.DINV.WD.GD.ZS

The data of Nepal is revealed to be quite low in terms of FDI per GDP in South Asia. FDI of Nepal has never reached 1 % of GDP within these four years. This is not the case in South Asia except Nepal. FDI flow per GDP was 1.7% in India, 1.6 % in Sri Lanka, 0.7% in Bangladesh and 0.6 % in Pakistan in 2011 while that of Nepal was 0.5%.

The country's industrial structure is characterized by a high GDP ratio of the primary sector (35% - largely agriculture), which absorbs around 70% of the total workforce, while the secondary sector including the manufacturing industry represents a small share of around 15%. Recently, the tertiary sector, led by tourism, transportation, and information and telecommunications, has been growing rapidly to account for nearly half of the GDP, but GDP as a whole expanded at a moderate 4% on average during the past decade. Relative to other member countries of the South Asia Association for Regional Cooperation (SAARC), the growth rate is slightly higher than those of Pakistan, Afghanistan, and Sri Lanka but is only one half that of India that is becoming a major economic power as a newly industrialized country (Table 1.1-2). The table indicates the underdevelopment of the country in which agriculture is still dominant in comparison to industrializing countries in the region. Incidentally, the Indian economy is much larger than those of the other SAARC member countries and thus has a great influence on them. It is true for Nepal, in which India has a large economic presence, but the converse is not true.

Table 1.1-2 SAARC's GDP and Poverty Ratio

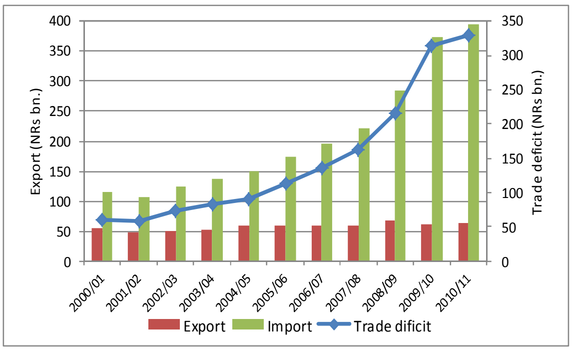
| | Afghanistan* | Bangladesh | Bhutan* | India | Maldives | Nepal | Pakistan | Sri Lanka |
|---|---|---|---|---|---|---|---|---|
| GDP (billion $) | 12.5 | 99.4 | 1.3 | **1,598.0** | 1.9 | 16.0 | 165.1 | 49.5 |
| Primary industry (%) | 32.5 | 18.8 | 18.7 | 19.0 | 5.3 | **35.0** | 21.2 | 12.8 |
| Secondary industry (%) | 22.1 | 28.5 | **43.2** | 26.3 | 11.9 | 15.0 | 25.4 | 29.4 |
| Tertiary industry (%) | 45.4 | 52.6 | 38.1 | 54.7 | **82.8** | 50.1 | 53.4 | 57.8 |

8 At present, approximately 3.55 million Nepalese work overseas and the amount of their remittance is estimated at Rs. 260 – 300 billion (around 20% of the country's GDP).

| | Afghanistan* | Bangladesh | Bhutan* | India | Maldives | Nepal | Pakistan | Sri Lanka |
|---|---|---|---|---|---|---|---|---|
| Population (million) | 26.1 | 146.2 | 0.7 | **1,182.0** | 0.3 | 28.3 | 166.5 | 20.7 |
| Per capita GDP ($) | 489.4 | 680.0 | 1,850.6 | 1,452.2 | **4,849.0** | 566.4 | 1,041.1 | 2,399.1 |
| Poverty ratio (%) | - | 49.6 | 26.2 | 41.6 | 1.5 | **55.1** | 22.3 | 15.2 |

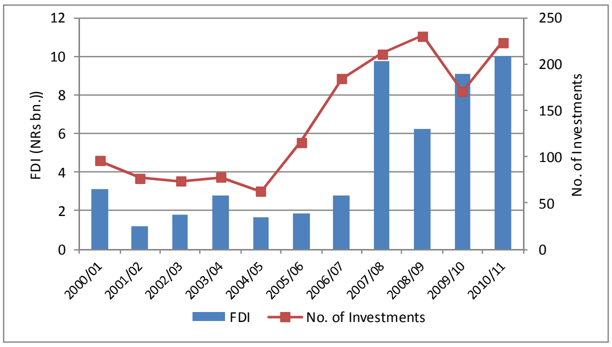
Note: *figure of 2009, and other figure are in 2010, poverty ratio is less than $1.25 per capita（2000－2008）
Source: Embassy of Japan in Nepal, Mat, 2012, and ADB Key Indicators 2011

In the field of international trade, Nepal's imports have been rapidly growing after 2006 when the internal conflict was over whereas exports, mainly agricultural and textile products, have not increased as much, which results in continuous expansion of trade deficits (Fig.1.1-1). This seems to be directly attributable to a limited range of export products and a small number of locally made industrial products that can substitute imports. A substantial amount of remittance from overseas workers that recently surpasses the country's export revenues appears to stimulate domestic consumption, which then leads to import growth too. Meanwhile, the country's economy depends heavily on trade with India, which accounts for 66.4% of total exports and 65.2% of total imports in the fiscal year 2010/11. Thus, diversification of export markets as well as items is a major challenge for the country's international trade.




Source: Embassy of Japan in Nepal

Figure 1.1-1 Trade Balance and Deficit




Source: Embassy of Japan

Figure 1.1-2 Transition of FDI

In contrast, foreign direct investment remains small (equivalent to 0.6% of GDP) and is far from boosting the national economy, although it has been growing steadily since 2007 in terms of the number of projects and the amount of investment (Figure 1.1-2). In recognition that the attracting foreign capital which comes with technology, information, and even market access/channels is highly effective in increasing exports as well as diversifying export markets, the Nepal government established the Nepal Investment Board (NIB) at the end of 2011 and declared the year 2012 as "Nepal Investment Year" to lure foreign investment at an accelerated pace However, it has yet to produce notable results partly due to the political instability.

(4) Overseas workers

As seen in other South Asian countries, a large number of Nepalese work overseas. According to the country's Population Census in 2011, 25.4% of all households (1.38 million) have at least one family member away from home, and 44.8% of such family members are said to fall in the young segment between 15 and 24 years. While some of them come from rural areas and work in Kathmandu and other large cities, many seem to work overseas. The study has revealed that a sizable number of young people go abroad for work. In particular, a relatively high percentage of young people in rural areas worked in foreign countries, thus causing labor shortage not only in the manufacturing sector but also in the agriculture sector. As of the end of 2011, estimated 3.55 million people worked overseas, and the estimated amount of remittance is Rs.260 – 300 billion (equivalent to around 20% of the country's GDP) according to official statistics, whereas an actual amount is said to be a several times larger. According to the Living Standard Survey 2011, approximately 80% of money remitted by overseas workers is used to purchase consumer goods[9].

### 1.1.2 Central and Local Government Organizations

(1) Central government

At present, Nepal's central government consists of 26 ministries including the Prime Minister's Office, and the cabinet is composed of Ministers appointed for each ministry. Under the Minister, each ministry has a Secretary[10], who presides over execution of his ministry's duties and serves as the representative of his ministry in the relationship with the Prime Minister. On the other hand, the Minister supervises his ministry in the sense that he represents it externally, and yet does not directly control or manage the ministry's operations. As a member of the cabinet, each Minister serves as an advisory body for the Prime Minister.[11]

Under the Secretary of a ministry, there are a few Joint Secretaries, under whom Under Secretaries are appointed. In comparison to the administrative bodies of the central government in Japan, the Secretary is largely equivalent to the Administrative Vice Minister, Joint Secretaries to Councilors/Bureau Chiefs, and Under Secretaries to Managers/Section Chiefs. It should be noted, however, that the Secretary plays a more active role in actual control and management of his ministry's operations, while the Joint Secretary assists him in management of the entire operations (or a specific field) and the Under Secretary controls and supervises a certain sections that provide actual public service. Meanwhile, some ministries have departments and boards that are under direct supervision of the Minister or the Secretary and serve as external organizations authorized to be engaged in a specific type of public service guided by the relevant ministries. These departments and boards are considered to be equivalent to agencies or boards in the Japanese government. For instance, the Department of Industry and the Department of Cottage & Small Industry, which are closely associated with this Study, are arms of the Ministry of Industry and implement policies and programs in relevant

[9] Furthermore, the detail of expenditure of remittance is as follows; loan payment 7.1%, family-owned assets 4.5%, education fee 3.5% and capital formulation 2.4%.

[10] The Secretary's primary role is close to that of the Permanent Secretary under the British government system from which the Nepal system is modeled after.

[11] Depending on the size of a ministry, a State Minister or an Under Secretary is appointed below the Minister.

fields as well as various types of public service. More precisely, the Ministry of Industry formulates policies and draft laws, based on which the departments implement programs and services. Note that the centralized government organization originated in Britain and was adopted on the basis of the system introduced to India during the colonial period.

(2) Local government organization

Local governments in Nepal have been administered in the form of the Panchayat system for around three decades since 1962. Although it was to introduce a new local government system under the new constitution that took effect in 1990, the internal conflict that lasted for around ten years since 1996 and the subsequent unrest continuing in the central government thereafter, have been preventing local elections from being held under the new system, which is thus still in the state of confusion. Then, the central government announced policy to decentralize local administration under the new constitution, based on which a new local government system was set forth under the new relevant laws[12]. Then, the Local Self Governance Act was established in 1999 to push forward active participation of local residents in the local government administration. In reality, however, as local elections have not been held since 1997, the Chief Officers sent as local development officers by the central government have continued to rein local administration in keeping with the intention of the central government.

Under the previous Panchayat system, the country was divided into 14 zones, 75 districts, 16 municipals, and around 4,000 villages. After 1992, the division was changed to five development regions, which consist of 75 districts, 58 municipalities, and 3,962 villages. The five development regions are divided and called, from east to west, East Region, Central Region, West Region, Midwest Region, and Far West Region (Figure 1.1-3). Each zone consists of four to eight districts, and all development regions contain three distinctive geographical areas of mountain, hill and the Terai. The head of each development region office is appointed by the central government and is considered to be the same rank as the Secretary of the central government.

[12] The District Development Committee Act, the Municipality Act, and the Village Development Committee Act


Figure 1.1-3 Sectional Map of Local Government

At lower levels, districts have District Development Committees and District Councils and villages do Village Development Committees and Village Councils[13]. Development Officers, the head of development committees, are appointed by the central government. Note that the smallest administrative unit is a Ward Division established in each village. In the future, however, the local government system is to be reorganized in time with local elections, and a final decision is to be made by the central government.

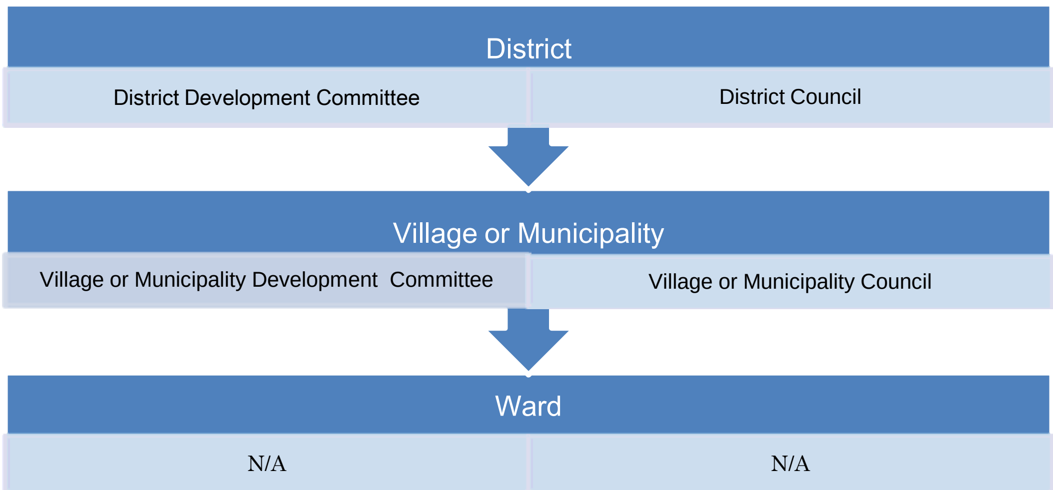


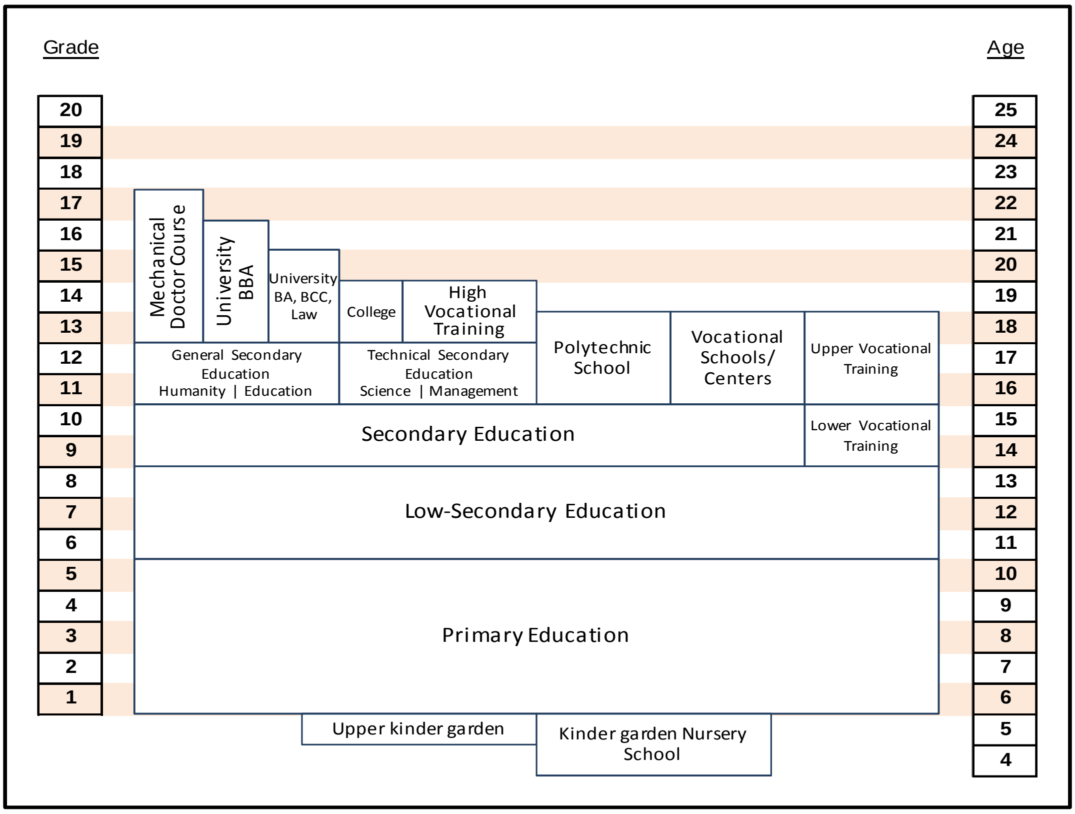

Figure 1.1-4 Local Public Administration in Nepal

[13] Due to the absence of regional electios, village or municipality council does not exist as of January, 2013.

### 1.1.3 Educational System and the Current State of Education

(1) Educational system

The educational system in Nepal is summarized in Figure 1.1-5. Primary education starts at 6 years old and is for 5 years with free of tuition (except private schools). While primary schools offer more or less the same course curriculum throughout the country and textbooks are supplied with free of charge, primary education is not mandatory. After primary schools, three-year low-secondary schools and two-year secondary schools follow. Many of low-secondary and secondary schools do not charge tuition, but students are required to buy textbooks and uniforms. Some students go to vocational schools after completion of lower-secondary education. Normally, students reach 15 years old when they graduate from secondary schools. Above secondary education, all graduating students take a nationwide examination to obtain a School Leaving Certificate (SLC), based on which results they choose education courses to advance. Then, they attend two years general or two to three years technical higher secondary education in preparation for college education or enroll in vocational schools and then go to college or find a job. College/university education takes 3-5 years in addition to a two-year general education program, depending on the field of study.




Source: JICA Study Team based on data from NIC
Remarks: Compulsory education is for 5 years of primary school. Peoples who want to proceed to the next stage of education have to take a promotion test after graduated secondary school.

Figure 1.1-5 Education System in Nepal

(2) Current state of education

Tables 1.1-3 and 1.1-4 present the changes in the numbers of primary and secondary schools and their enrollments in the recent five years. Note that the enrollment data shows the sum of the number of students in five grades for primary schools, that in three grades for lower-secondary schools, and that in two grades for secondary schools. While primary schools accommodated around one million students in 2010, enrollment in lower-secondary schools of the same year was less than half, around 540 thousand, and that in secondary schools decreases further. The marked decrease in enrollment at secondary education levels can attribute to various factors, including household income, access to schools in mountain areas, and cultural and social issues in the multiracial country.

Table 1.1-3 Number of Schools

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| Primary Schools | 27,901 | 29,220 | 30,924 | 30,093 | 31,618 |
| Lower Secondary School | 8,880 | 9,739 | 10,636 | 10,487 | 11,456 |
| Secondary School | 5,329 | 5,894 | 6,516 | 6,235 | 6,813 |

Source: Department of Education

Table 1.1-4 Number of Students in First Three Levels

| | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|
| Primary Schools | 4,515,059 | 4,418,713 | 4,782,313 | 4,828,630 | 4,986,805 |
| Lower Secondary School | 1,354,178 | 1,443,515 | 1,466,862 | 1,502,930 | 1,612,892 |
| Secondary School | 645,904 | 671,183 | 715,378 | 719,629 | 778,905 |

Source: Department of Education

As for post-secondary education, there were 54,519 graduates in 2010 (Table 1.1-5). Popular areas of specialty are management, education, and humanities & social science. The number of graduates from engineering departments is close behind. However, they cannot find a sufficient number of employment opportunities in the country, and it is pointed out that basic foundation engineering education they receive at college does not match practical knowledge and skills demanded in the job market, although it is noteworthy that quality of education in the country as a whole has been improving gradually.

Table 1.1-5 Number of Graduates of Higher Education, 2009/10

| | TU | KU | Poku | PurU | NSU | BPKIMS | Total |
|---|---|---|---|---|---|---|---|
| Science &. Technology | 2553 | 147 | 489 | 173 | | | 3,362 |
| Management | 11,723 | 315 | 533 | 1,089 | | | 13,660 |
| Humanities &. Social Science | 10,822 | 156 | 31 | 177 | | | 11,186 |
| Education | 13,355 | 48 | | 114 | 385 | | 13,902 |
| Law | 288 | | | 54 | | | 342 |

| | TU | KU | Poku | PurU | NSU | BPKIMS | Total |
|---|---|---|---|---|---|---|---|
| Engineering | 9,189 | 113 | | | | | 9,302 |
| Medicine | 346 | 792 | | 557 | 4 | 176 | 1,875 |
| Forestry | 104 | | | | | | 104 |
| Agriculture &. Animal Science | 196 | | | | | | 196 |
| Ayurred Sanskrit | | | | | 590 | | 590 |
| Total | 48,576 | 1,571 | 1,053 | 2,164 | 979 | 176 | 54,519 |

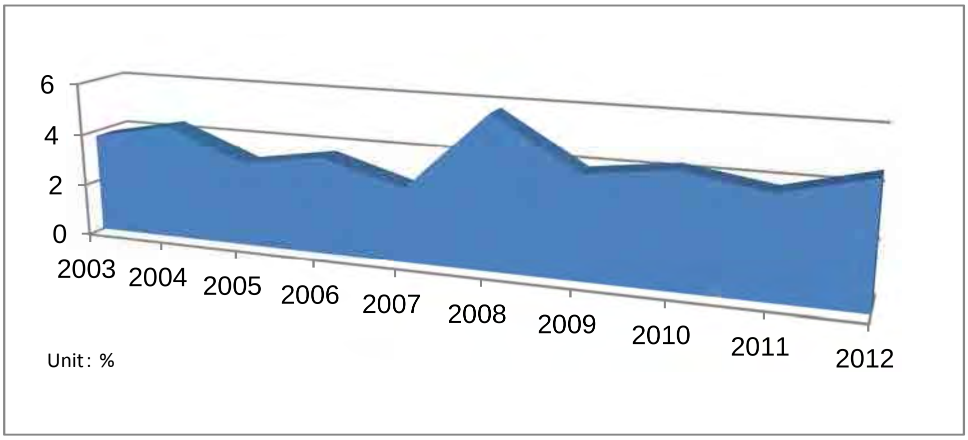
Source: Department of Education

## 1.2 Economic and Social Conditions

### 1.2.1 Macroeconomic Trend

(1) Real GDP growth

Nepal's real GDP achieved the average growth rate of 4% between 2003/04 and 2011/12, with GDP per capita growing from $293 to $735[14]. As shown in Fig.1.2-1, real GDP growth rates were relatively steady during the 9-year period, ranging between 2.8% (2007) and 5.8% (2008), although GDP per capita remains low due to a very low level of GDP.




Source: Ministry of Finance `Economic Survey 2011/2012

Figure 1.2-1 GDP Economic Growth Rate in Nepal

The average sectorial growth rate during the same period was 3.7% for agriculture, 2.9% for manufacturing, and 5.8% for service. The agricultural sector varied greatly between 1.0% (2006/07) and 5.8% (2007/08) mainly due to a high dependency on weather conditions and insufficient investment. Similarly, the manufacturing sector failed to show a sporadically varying pattern between -0.6% (2008/09) and 4.4% (2005/06), reflecting the fact that the country's exporters are highly affected by the global market. Especially, it is vulnerable to the Indian market trend to indicate the lack of geographical diversification efforts.

On the other hand, the service sector shows a higher average growth rate of 5.8% in comparison to the above two sectors, with a rather large variation between 3.3% (2008/05) and 7.3% (2007/08). This is said to be attributable to growth of demand for the service industry in urban areas as well as the increase in consumer spending on account of increased remittance by overseas workers.

[14] The figure in 2012 is provisional.

(2) Consumer price index

The country's CPI has been showing relatively high rates of increase since 2006. Generally, South Asia shows higher rates of CPI growth in comparison to other regions. Within the region, Nepal is one of the countries – in addition to India and Pakistan – that experience consistently high inflation rates. Table 1.2-1 summarizes the country's recent CPI and SWRI (salary and wage rate index) trends. Notably, SWRI follows an upward trend since 2009, concurrently with CPI growth, which constitutes a negative factor relating to new investment in the country.

Table 1.2-1 Transition of CPI and Salary and Wage Index

| | 2005/06 | 2006/07 | 2007/08 | 2008/09 | 2009/10 | 2010/11 | 2011/12 |
|---|---|---|---|---|---|---|---|
| CPI (%) | 8.0 | 5.9 | 6.7 | 12.6 | 9.6 | 9.6 | 7.7 |
| GDP Deflator (%) | 6.9 | 7.3 | 5.6 | 16.1 | 14.4 | 11.2 | 9.7 |
| Salary & Wages Rate Index (%) | 3.9 | 9.8 | 9.7 | 15.3 | 17.2 | 18.0 | 27.6 |

Source: Economic Survey 2011/12, Ministry of Finance

Thus, the relatively low rates of economic growth in Asia (although being steady), the continued uptrend in domestic prices, and expansion of trade deficits (as discussed later) are minus factors for the national economy and its future outlook, while the country is required to boost the national economy by spurring investment.

### 1.2.2 Changes in Industrial Structure

(1) Sectorial GDP composition

Table 1.2-2 summarizes growth rates of key sectors and their GDP shares in recent years. Up to the early 1980s, Nepal was slow in modernizing its industrial structure, which was characterized by heavy dependency on the agricultural sector, vulnerable to weather conditions and dominated by small farms with low productivity; it continued to account for 60-70% of GDP between the 1960s and the early 1980s. Then, a major change started afterwards with various structural reforms and liberalization policy[15].

As a result, the agricultural sector's GDP share declined to 51% in 1985, 40% in 2000, and around 36% in and after 2007. Meanwhile, the service sector gained share. Its growth rate exceeded the agricultural sector in the late 1990s to become the largest economic sector. In 2012, the sector represented around 50% of GDP. Within the service sector, commerce is the largest subsector, followed by transport, communication, real estate, and education. The Hotel

[15] The structural reforms included privatization of state enterprises, deregulation, and attraction of foreign direct investment.

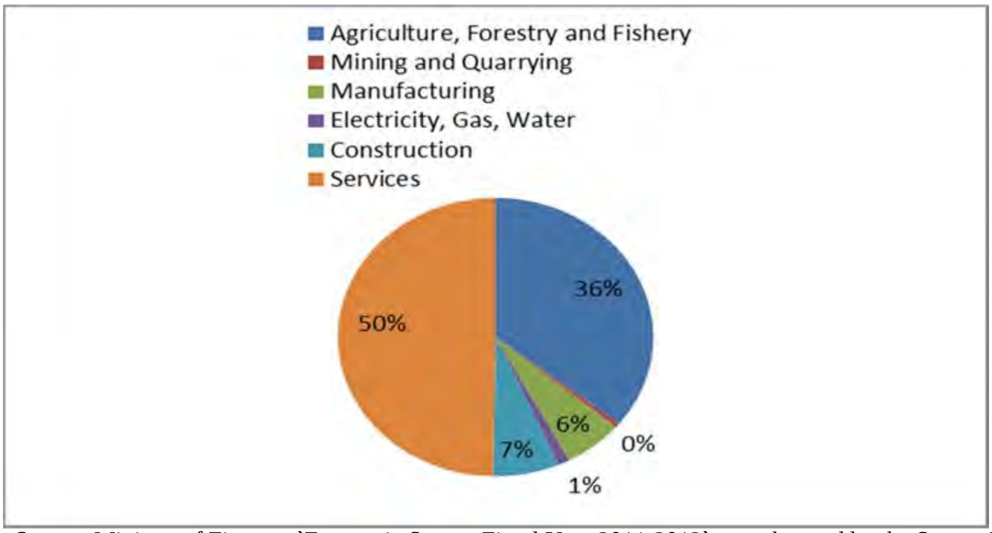
and Restaurant represent 1.7% of GDP. It is estimated that Tourism accounts for 3.7% of GDP.[16] The manufacturing sector holds a 15% share with a slight declining trend. While Nepal's economy is now dominated by the service sector, its GDP share is rather small in comparison to other SAARC countries and the country is still viewed as an agricultural country.

Table 1.2-2 GDP Annual Growth

Unit : %

| Year | Agriculture | | Industry | | Service | |
|---|---|---|---|---|---|---|
| | Growth Rate | GDP proportion | Growth Rate | GDP proportion | Growth Rate | GDP proportion |
| 2005/06 | 1.9 | 37.1 | 4.4 | 16.3 | 5.6 | 46.6 |
| 2006/07 | 1.0 | 36.3 | 4.0 | 16.4 | 4.5 | 47.3 |
| 2007/08 | 5.8 | 36.3 | 1.6 | 15.7 | 7.3 | 47.9 |
| 2008/09 | 3.0 | 36.0 | -0.6 | 15.1 | 6.0 | 48.9 |
| 2009/10 | 2.0 | 35.3 | 4.1 | 15.0 | 5.8 | 49.7 |
| 2010/11 | 4.5 | 35.5 | 2.9 | 14.9 | 3.6 | 49.6 |
| 2011/12 | 4.9 | 35.6 | 1.6 | 14.5 | 5.1 | 49.9 |

Note: GDP proportion indicates the percentage of each category to the total amount of GDP, and it is calculated by the Survey Team.
Source: Economic Survey 2011/12, Ministry of Finance




Source: Ministry of Finance, `Economic Survey Fiscal Year 2011-2012`, corroborated by the Survey Team

Figure 1.2-2 Sectorial GDP proportion (2010)

Fig.1.2-3 shows the sectorial GDP composition on the basis of 2010 data, which is considered to represent the country's latest industrial structure very accurately. As pointed out earlier, the service sector accounts for around 50% of GDP and the commerce subsector around one fourth. Economic value of Tourism market is said to be around USD 3 Million. The

[16] GDP of Hotel and Restaurant is USD 11 billion 217 million while that of Tourism is equivalent of USD 25.5 billion. The former accounts 43.9% of the latter. The proportion of Hotel and Restaurants to GDP, 1.7%, was divided by the proportion between the former and the latter. Thus, the size of Tourism per GDP was estimated to be 3.86 %.

transport/storage/communication and real estate subsectors account for slightly less than 20%, each, of the service sector's output. Then, the agriculture, forestry and fishery sector represents more than one third of the total GDP.

### 1.2.3 Labor Market and Social Development

(1) Working population

According to the government survey that was conducted under ILO's assistance , the country's total labor force increased from 9,463,000 in 1998 to 11,779,000 in 2008. Table 1.2-3 shows breakdown of the working population by sector, gender, and urban/rural area, as obtained from the 2008 survey. Notably, the agricultural sector generates 73.9% of the country's total employment and other sectors account for the remaining 26.1%. Among the non-agriculture sectors, manufacturing, commerce and education hold relatively high shares, although they are much smaller than the agricultural sector. As for gender composition, women hold a higher share than men in the agricultural sector[17], while the reverse is the case for manufacturing and other non-agriculture sectors, suggesting that Nepal has traditionally reluctant to promote social participation of women.

Table 1.2-3 Nepal Labor Force Distribution

(%)

| | Nepal | | | Urban | | | Rural | | |
|---|---|---|---|---|---|---|---|---|---|
| | Total | Male | Female | Total | Male | Female | Total | Male | Female |
| Agriculture and forestry | 73.87 | 62.09 | 84.26 | 32.18 | 19.88 | 47.65 | 80.12 | 69.83 | 88.71 |
| Fishing | 0.03 | 0.04 | 0.02 | 0.00 | 0.00 | 0.00 | 0.03 | 0.04 | 0.02 |
| Mining and quarrying | 0.23 | 0.34 | 0.13 | 0.20 | 0.23 | 0.15 | 0.23 | 0.36 | 0.13 |
| Manufacturing | 6.56 | 8.50 | 4.87 | 13.94 | 15.56 | 12.06 | 5.46 | 7.20 | 4.00 |
| Electricity, gas and water | 0.93 | 0.71 | 1.12 | 2.08 | 1.52 | 2.79 | 0.75 | 0.58 | 0.91 |
| Construction | 3.12 | 5.91 | 0.66 | 4.89 | 7.60 | 1.47 | 2.85 | 5.60 | 0.56 |
| Wholesale, retail & trade | 5.87 | 8.10 | 3.91 | 17.20 | 19.77 | 13.97 | 4.18 | 5.96 | 2.69 |
| Hotels and restaurants | 1.67 | 1.70 | 1.65 | 6.06 | 5.38 | 6.91 | 1.02 | 1.01 | 1.00 |
| Transport, storage & comm. | 1.68 | 3.46 | 0.13 | 4.23 | 7.13 | 0.59 | 1.30 | 2.79 | 0.07 |
| Financial intermediation | 0.27 | 0.40 | 0.16 | 1.30 | 1.64 | 0.88 | 0.12 | 0.19 | 0.05 |
| Real state, renting & business | 0.60 | 1.03 | 0.21 | 2.35 | 3.39 | 1.03 | 0.34 | 0.62 | 0.11 |
| Public administration & defense | 0.93 | 1.74 | 0.21 | 3.52 | 5.61 | 0.88 | 0.54 | 1.03 | 0.11 |
| Education | 2.42 | 3.42 | 1.53 | 5.73 | 5.85 | 5.59 | 1.93 | 2.98 | 1.04 |
| Health and social work | 0.65 | 0.83 | 0.50 | 1.95 | 1.99 | 1.91 | 0.46 | 0.62 | 0.32 |
| Other community & social act. | 0.84 | 1.40 | 0.37 | 2.87 | 3.63 | 1.91 | 0.54 | 0.99 | 0.16 |
| Private households workers | 0.28 | 0.25 | 0.30 | 1.37 | 0.82 | 2.06 | 0.12 | 0.15 | 0.09 |
| Extra-territorial organization | 0.04 | 0.07 | 0.02 | 0.13 | 0.12 | 0.15 | 0.03 | 0.06 | 0.00 |
| Total (in thousands people) | 11,779 | 5,519 | 6,259 | 1,535 | 855 | 680 | 10,244 | 4,664 | 5,580 |

Note: Currently employed persons aged 15 years and over by sex
Source: Central Bureau of Statistics. 2009. Report on the Nepal Labour Force Survey 2008.

[17] IFAD reports that rural female in the developing countries dedicates on the multi-tasks in a daily basis. Regarding agriculture, they plant, weed, harvest crops and feed livestock. As a caretaker, they look after children and relatives, prepare meals and manage homes.

When Tables 1.2-2 and 1.2-3 are compared, it is indicated that, while the breakdown of the labor force by sector does not well agree with the industrial structure, Table 1.2-3 is considered to represent the present state of the country better than Table 1.2-2 in the sense that the former sheds light on the industrial structure from urban and rural perspectives. It should be noted that Table 1.2-3 shows the labor force of 15 years and older, while there seems to be a sizable number of rural workers who are less than 15 years old (both men and women).

According to the labor force survey, the country's unemployment rate was 2.1% as of 2008. However, the unemployment rate in urban areas reached 7.5%. In particular, that of the 15 to 24 age group in urban areas was as high as 13%. These data reflect the present state of the labor market that is characterized by the inflow of labor force from rural to urban areas as a result of the decline of the agricultural sector, but there is not a sufficient number of employment opportunities in cities and many workers go abroad to find jobs.

During the interview survey conducted by the study team of rural areas, it was pointed out that a significant increase in the number of young people working overseas causes labor shortage in various sectors including agriculture. Recently, 350,000 – 400,000 people, mainly young ones, are said to go overseas each year for work and nearly 3.6 million people are estimated to work in foreign countries. While their remittance contributes greatly to the national economy as a major source of consumer spending, the country's sustainable economic growth should depend on the development of a healthy labor market that can absorb a high percentage of new entrants over a long period of time.

Remittance from abroad reaches 20% of GDP. This ratio is quite high even in the global level. It is next to none except Tajikistan, Lesotho, Samoa and Kirgiz. Actually, the remittance per GDP of Nepal is the fifth in the world by the World Bank's data.

Youth, especially rural male, go abroad and send remittance. It has improved the income in the rural area as well as the life standard and consumption. On the other hand, it also raised some issues such as social and financial ones. For instance, these workers have to pay back the loans, and it amounts to 7% of periodical remittance. Social issue is more serious concern. After the departure of young males, aged group, females and kids are left in the rural area. It lowered the productivity due to the lack of males who have physical strength. Long-term working abroad also exposes the family to the risk of break-up.

These issues may become more serious in the near future considering that working abroad becomes more popular after 2002 and is recent socioeconomic change. Thus, exit strategy of remittance-dependency should be prepared. In fact, Central Bank high rank officers consider it as one of the top priorities.

(2) Employment in the informal sector

The labor force survey covered the informal sector as well as the formal one. The survey of the informal sector was conducted according to ILO's definition and the number of workers in the formal sector was estimated, including those in the non-agriculture sectors who did not receive regular salary or wage. As of 2008, 2,142,000 persons were estimated to work in the informal sector, equivalent to 18.2% of the total labor force of 11,779,000 persons (Table 1.2-4). They also accounted for 69.7% of the total work force in the non-agriculture sectors. Although the definition of informal sector workers does not include farmers, many of them should be considered as workers in the informal sector because they cannot find other jobs and have no choice but to be engaged in farming. If they are added, the workforce in the informal sector will become much larger.

Table 1.2-4 Informal sector labor force above 15 years old

Unit : 1,000 workforce, %

| | |
|---|---|
| Total (A) | 11,779 |
| Agriculture | 8,705 |
| Non-agriculture, total (B) | 3,074 |
| Non-agriculture, formal sector | 932 |
| Non-agriculture, informal sector (C) | 2,142 |
| with 1-9 regular paid employees | 1,750 |
| without regular paid employees | 392 |
| Employment in non-agricultural informal sector among total employment (C/A) | 18.2% |
| Employment in non-agricultural informal sector among non-agricultural sector (C/B) | 69.7% |

Source: Central Bureau of Statistics. 2009. Report on the Nepal Labour Force Survey 2008.

(3) Labor unions

Labor unions in Nepal are closely linked to political parties, creating a risk for the manufacturing sector that labor disputes easily erupt with involvement of political activists. The study team's interview survey revealed that many companies have multiple labor unions supported by different political parties and workers belong to one of them. Labor unions are allowed to make unified demands to the employer every other year, which cover a wide range from wages and welfare to work safety and environmental impacts. If unions think that the employer does not meet their demands effectively, they carry out a lockout, strike and/or demonstration. In extreme cases, factories have been forced to suspend operation[18].

According to the MoL, 85 labor unions are registered at national level, of which 57 are considered to be active. Department of Labor regulates labor unions, which are required to renew registration pursuant to the Trade Union Act of 1992.

[18] As Nepal`s Bankruptcy law is not practically effective, suspension of business operation for an extensive period of time means its bankruptcy.

Furthermore, labor unions are organized into three labor union federations. The oldest labor union federation is Nepal Trade Union Congress Independent (NTUCI). It boasts approximately 431,000 members after merging with Democratic Confederation of Nepal Trade Unions (Decont). It supports the political party, Nepal Congress. The second federation is General Federation of Nepalese Trade Unions (GeFont) and is said to have around 500,000 members. Politically, it supports CPN-UML. Finally, there is AN-TUF that supports the Communist Party of Nepal (Maoist).

Table 1.2-5 summarizes labor regulations currently enforced in the country, including working hours and fringe benefits.

Table 1.2-5 Working hours and Social Welfare defined by the Labor Act

| | |
|---|---|
| Working days | 6 days a week |
| Working hours | 48 hours a week（8 hours per day） |
| Rest | 30 minutes |
| Overtime work | 150% per one hour（maximum 20 hours a week） |
| Annual Holidays | National 13 holidays + 1 Labor Day |
| Home Leave | 18 days a year |
| Maternity Leave | 52 days a year |
| Paid Sick Leave | 15 days a year |
| Other Paid Leaves | Special Leave、Unpaid Leave, |
| Minimum Wage | Minimum Remuneration Committee submit a recommendation to the government every 2 years |

Source: Investment Board[19]

Remuneration consists of basic salary/wage and dearness allowance, as shown in Table 1.2-6. The sum of the two components constitutes the minimum wage. Until 2008, basic salary and wage was established according to type of labor (skill), and it was unified regardless of skill level after 2010. By the same token, dearness allowance has been unified after 2010. The unification often causes dissatisfaction of skilled workers. The study team's interview survey of local business owners indicates that they always face shortage of skilled workers despite of employment opportunities. Also, there are cases where new employees who have received skill training leave their employer and go abroad for work.

Table 1.2-6 Minimum Wage and Allowance

Minimum Wage

Unit: Nr

| | Type of Labor | 1990 | 1992 | 1994 | 1997 | 2000 | 2003 | 2006 | 2008 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Un-Skilled | 800 | 1,000 | 1,000 | 1,300 | 1,450 | 1,700 | 2,200 | 3,050 | 3,550 |
| 2 | Semi-Skilled | 850 | 1,050 | 1,050 | 1,350 | 1,500 | 1,750 | 2,250 | 3,100 | |
| 3 | Skilled | 958 | 1,160 | 1,160 | 1,460 | 1,610 | 1,860 | 2,360 | 3,210 | |
| 4 | Highly-Skilled | 1,142 | 1,350 | 1,350 | 1,650 | 1,800 | 2,050 | 2,550 | 3,400 | |

19 http://www.investnepal.gov.np/portal/index.php?p1=content&p2=8&mid=16

Dearness Allowance

Unit:Nr

| | Type of Labor | 1990 | 1992 | 1994 | 1997 | 2000 | 2003 | 2006 | 2008 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|
| 1 | Un-Skilled | 50 | 150 | 450 | 500 | 666 | 860 | 1100 | 1550 | 2650 |
| 2 | Semi-Skilled | 50 | 150 | 450 | 500 | 666 | 860 | 1100 | 1550 | |
| 3 | Skilled | 50 | 150 | 450 | 500 | 666 | 860 | 1100 | 1550 | |
| 4 | Highly-Skilled | 50 | 150 | 450 | 500 | 666 | 860 | 1100 | 1550 | |

Source: Nepal Gazette

(4) Human development

Despite the political unrest and the slow economic growth, Nepal has achieved some improvement in the area of poverty reduction; the percentage of population below the poverty level declined from 41.7% in 1995 to 30.9% in 2003, then to 25.2% in 2011[20]. The significant decline in population living under the poverty line seems to be attributable to the following three factors: 1) remittance by people working overseas; 2) increase in population migrating from rural to urban areas, which results in higher income; and 3) increased business activities relating to agriculture. Also, some point out that the improvement of road conditions – the percentage of paved roads rose from 37.5% in 2000 to 56.9% in 2004 – has encouraged movement of people, goods and information by improving accessibility in rural areas, thus increasing employment opportunity[21].

As shown in Table 1.2-7 that summarizes economic differentials in SAARC countries, however, all the countries in South Asia with exception of India and Pakistan[22] have experienced the increase in difference between the rich and the poor between the 1990s and the 2000s. This means that, while the percentage of the poor has declined, the rich has become richer to increase the economic differentials. In fact, the GINI coefficient in all the countries has increased over a short period of time, coinciding with economic development.

Table 1.2-7 Economic Gap among SAARC members

| Country | Period | GINI Index | | |
|---|---|---|---|---|
| | | First year | Last year | Annual Average Growth Rate (%) |
| Nepal | 1995-2003 | 0.38 | 0.47 | 2.85 |
| Bangladesh | 1991-2005 | 0.28 | 0.34 | 1.34 |
| India | 1993-2004 | 0.33 | 0.36 | 0.88 |
| Pakistan | 1992-2004 | 0.30 | 0.31 | 0.24 |
| Sri Lanka | 1995-2002 | 0.34 | 0.40 | 2.24 |

Source: ADB `Critical Development Constraint` Statistics Database System`

[20] Population below the poverty line means a household that lives on Rs.19,261 per person and per year (Rs.52.7 per day) as of 2010.

[21] `Enterprise Survey` ILO, ADB, FNCCI, 2008

[22] During the period, little change was seen in India and Pakistan, in terms of both economic development and income distribution.

In Nepal, inequality between the rich and the poor has increased despite a decline in the percentage of the latter. As measured by the GINI index, Nepal experienced the largest increase in inequality among SAARC countries between the mid-1900s and the mid-2000s; income earned by the top 20% exceeded that of the lowest 20% by more than 10 times.

One factor for causing the inequality is the difference in level of education of the head of the household who is the breadwinner. When the head of the household does not receive high education, he or she can only find a low-paying, unstable job. As a result, other family members are required to work and children are deprived of educational opportunity, resulting in low level of education and forcing them to repeat the vicious cycle of poor education and low-paying employment. Other factors are also working, including the difference in labor market growth between different trades and skills, and social discrimination based on gender, race or caste, which constitutes a deeply rooted problem.

Women in Nepal are placed in very unfavorable conditions in terms of opportunity (education and health service), property ownership, freedom to move, and social status. Similarly, racial minorities (Limbus, Magars, Mushahars, and Tamangs Tharus) and low-caste people show high percentages of poverty. These conditions are evidenced by not only economic indicators but also the human development index. As shown in Table 1.2-8, Nepal ranked 157$^{th}$ among 187 countries in terms of human development index, lowest in South Asia. To improve the situation, a U.N. report points out the need for improvement of basic public service in terms of supply, such as education, health care, and access to drinking water[23]. Also, Nepal ranks lowest in the region in terms of national income per capita, based on purchasing power parity (PPP), which suggests the need for grass-roots economic activity support in the form of job creation and entrepreneurship promotion.

Table 1.2-8 Human Development Index South Asia

| Index | Criteria | Unit | Nepal | Bangladesh | Bhutan | India | Pakistan | Sri Lanka |
|---|---|---|---|---|---|---|---|---|
| Human Development Index | Out of 187 countries | Ranking | 157 | 146 | 141 | 134 | 145 | 97 |
| Health | Life Expectancy at birth | Years | 68.8 | 68.9 | 67.2 | 65.4 | 65.4 | 74.9 |
| Education | Mean years of schooling | Years | 3.2 | 4.8 | 2.3 | 4.4 | 4.9 | 8.2 |
| GNI per capita in PPP | Constant 2005 International | USD | 1,160 | 1,529 | 5,293 | 3,468 | 2,550 | 4,943 |
| Inequality | Adjusted HDI value | Index | 0.301 | 0.363 | n.a. | 0.392 | 0.346 | 0.579 |
| Poverty | Multidimensional poverty index | Greater than 3 | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| Gender | Gender Inequality Index | Index | 0.665 | 0.597 | n.a. | 0.645 | 0.611 | 0.447 |
| Sustainability | Adjusted net savings | % of GNI | 29.1 | 27.1 | n.a. | 24.1 | 10.7 | 16.4 |
| Demography | Population | 1,000 | 30,486 | 150,494 | 738.3 | 1,241,492 | 176,745 | 21,045 |
| Composite indices | Non-income HD value | | 0.524 | 0.566 | 0.5 | 0.568 | 0.526 | 0.768 |

Note: Out of 187 countries
Source: UNDP Human Development Report 2011

23 \`Human Development Report 2007/2008\` United Nations Development Programme

## 1.3 Issues identified from Macroeconomic Indicators

### 1.3.1 Macroeconomic and Development Issues

(1) Small local job market and increase in the number overseas workers

The Nepalese economy has been growing steadily, albeit slowly. During the period of internal strife between 1996 and 2006, the economy achieved an annual average growth rate of 3.5%. The relatively stable pace of economic growth continues since then. For the country to develop from a LLDC to a semi-developed (newly industrializing) country, however, it will take more than 30 years if the economy grows at the present pace.

It should be noted that economic growth achieved so far has been primarily driven by growth of consumer spending fueled by money sent by overseas workers, rather than development of manufacturing and other industries within the country. Furthermore, significant portions of money sent by overseas workers were deposited with financial institutions and were diverted to speculative investment in real estate property, not productive investment that leads to industrial development. At the same time, companies do not have a direct financing method due to an ineffective stock market (financial institutions account for 95%) and the absence of the bond market.

Meanwhile, remittance by overseas workers has exceeded $2.2 billion, equivalent to 20% of GDP, and continues to rise. As a result, around 52% of households benefit from remittance by migrant workers (including those working in urban areas away from home). While the poverty rate is improved, it is by no means a result of economic development within the country.

(2) Slow growth of the secondary and tertiary industries

From macroeconomic perspectives, Nepal’s economic base has shifted from agriculture to service. From the 1960s to the 1980s, the agricultural sector accounted for around 70% of GDP. In 2010, the GDP share fell to 35%. On the other hand, the service sector’s share grew rapidly to 50% in 2010 partly due to ample labor supply by workers who came from rural areas. As seen in the analysis of the labor force and its composition, however, the agricultural sector still maintains its strong presence. In light of the fact that the service sector is mainly composed of retailers and wholesalers, where the informal sector plays a major role, it is critical to promote development of the mining, manufacturing, and tourist industries, which can contribute greatly to economic development in terms of wealth and employment.

The manufacturing sector grew strongly in the mid-1990s as driven by economic liberalization policy and accounted for 20% of GDP. However, it lost competitiveness due to the reverse trend toward protectionism and continues to stagnate after 2000, together with sluggish exports, as reflected in a much lower level of GDP contribution in 2007. On the other hand, the tourism, which is recovering from a significant decline caused by the political turmoil, can develop further to serve as a main economic engine.

# Chapter 2 Economic and Industrial Policies

# Chapter 2 Economic and Industrial Policies

## 2.1 National Economic Development Plans

### 2.1.1 Historical Background and Current State of National Economic Development Planning

Nepal has a long history of national economic development planning. The first five-year development plan, which was formulated in 1956, and successive plans have served as a national economic development policy guideline of the time[1]. At present, National Planning Commission is responsible for formulating them. The national development plans to this date are generally summarized as follows.

The first to the third development plans put priority on development of social infrastructure and undeveloped land, according to which road construction between Kathmandu and Birganj (located near the border with India) and other projects were carried out to build the country's backbone. In the 1970s, the country launched a regional development scheme dividing it into four areas. However, its results seem to have fallen short of the goals during the decade due to the Indo-Pakistani War and oil crises. It is not until the 1980's that Nepal incorporated into development plans perspectives of economic and industrial development, such as agricultural development, local industry promotion, and correction of regional disparity.

In the 1990s, the government started economic liberalization to reflect the political moves toward democracy, and the 8th five-year development plan (1992/93–1996/97) included deregulation in the secondary and tertiary sectors. Meanwhile, it inherited priorities of their predecessors such as (1) sustainable economic development, (2) poverty reduction, and (3) correction of regional disparity. In pararell, it also formulated "Agricultural Perspective Plan (APP) 1994/95 – 2014/15" which aimed to promote growth from long-term perspectives (see 3.1.2.1 of this report). From economic liberalization policy perspectives, it was decided to include deregulation in the secondary and tertiary industries.

The 9th five-year development plan (1997/98 – 2001/02) continued to emphasize anti-poverty measures, especially income generation in rural areas, and set forth (1) implementation of vocational training and empowerment programs; (2) vigorous creation of employment opportunities; (3) promotion of APP; and (4) reduction of the poor. Concurrently with the formulation of the 9th development plan, the government announced a long-term development strategy plan for 1997-98 – 2016/17, articulating the government's fundamental position for long-

[1] The 1st five-year plan was announced in 1995 and its implementation started in 1956. After the 10th five-year development plan (2002/03 – 2007/08), however, no five-year plan has been announced.

term economic development in accord with liberalization policy. To achieve a longstanding goal of poverty alleviation, it sets a specific target to lower the poverty rate from 42% in 1996 to 10% in 2017 and shows basic directions on macroeconomic policy and sectorial development plans. Unfortunately, however, achieving the target at the end of the 9th development plan period was highly doubtful, and the 10th development plan was formulated.

In response to the aggravation of balance of payments in 1985, the government launched structural adjustment policy in consultation with the IMF and the World Bank, and the 10th five-year plan (2002/03 – 2007/08) was formulated in February 2003 as the Poverty Reduction Strategy Paper (PRSP)[2]. In the 10th five-year plan, the government incorporated the Medium Term Expenditure Framework (MTEF) specifying a three-year expenditure outline, the schedule under the plan, and the Immediate Action Plan (IAP) designating projects to be implemented immediately as the commitment to the plan.

Poverty reduction remains the primary goal of the 10th five-year plan. Aiming to reduce the poverty rate from 38% to 30% in the five-year period, the plan set the GDP growth target of 6.2%, which is broken down to 4.1% growth in agriculture and 7.5% in the rest of the economy. Key strategies emphasized are: (1) high economic growth with an emphasis on growth of local economy; (2) effective provision of basic social service and development of economic infrastructure; (3) mainstreaming of the poor and women into the development process; and (4) good governance. In addition, four factors to make consideration are also listed, namely special consideration to rural regions, development with immediate effect, strong strategic orientation, and flexible reconsideration and modification of plans.

After the 10th development plan, the government attempted to develop a new five-year plan but established three-year development plans instead to achieve goals within a shorter span of time. Up to now, two three-year plans (2007/08 – 2009/10 and 2010/11 – 2012/13) have been formulated and the latter which was announced in August 2010 is currently underway.

### 2.1.2 Role of National Planning Commission

National Planning Commission (NPC) is the advisory body for formulating development plans and policies of the country under the directives of the National Development Council (NDC). NPC is chaired by the Prime Minister, and the Commission has a full-time vice-chairman, seven members and a secretary. The functional divisions are under the name of Economic Management, Social Development, Infrastructure Development, Poverty Monitoring, Agriculture and Rural Development, and General Secretary Office.

[2] Interim Poverty Reduction Strategy Paper (I-PRSP) was announced in July 2001 and was used the basis of the 10th five-year development plan.

NPC is responsible for formulating national development plans and PRSP, drawing out annual development plans, and assessing results. As seen from the composition of the national development plans, NPC does not have divisions responsible for industrial sectors other than agriculture, although some staff members are in charge of industry, tourism and other non-agricultural sectors. However, these non-agricultural sectors are taken care of as part of efforts to develop rural areas or improve standards of living, clearly indicating that the government's industrial development policy is strongly inclined to agriculture. In line with the national development plan of the time, line ministries set forth policy guidelines or development plans such as Industry Policy (by the Ministry of Industry) and Trade Policy (by the Ministry of Commerce and Supplies).

### 2.1.3 General Outline of the Three-year Plan (2009/10 – 2012/13) and Development Policy for Key Sectors

As pointed out earlier, three-year plans serve as substitute for five-year plans. The ongoing three-year plan, entitled "Three Year Plan Approach Paper", continues to set the highest priority to poverty reduction and draws out sectorial development goals and strategies accordingly. Also, it aims to achieve the Millennium Development Goals (MDGs) by 2015. The goal, objective, strategies and priority sectors stipulated in it are as follows.

(1) Goal

The goal of the plan is to improve living standards of all Nepalese people, reduce poverty, and achieve the MDGs by 2015 through sustainable economic growth, more concretely, generating employment opportunities, reducing economic inequalities, achieving regional balances, and eliminating social exclusions.

(2) Objective

The main objective of the plan is to enable people to feel improvement in their livelihood and quality of life by alleviating poverty and establishing sustainable peace through employment-centric, inclusive and equitable economic growth.

(3) Strategy

1) To achieve employment centric, poverty alleviation oriented, sustainable and broad-based economic growth with the joint efforts of the government, private and community/co-operatives sectors.
2) To develop physical infrastructure to support both the future federal structure of the nation and regional economic development.
3) To emphasize on inclusive and equitable development to achieve sustainable peace.
4) To contribute to socioeconomic and social services

5) To make development works result-oriented through ensuring governance and effective service delivery.
6) To strengthen economic growth and stability by developing private and community/ cooperative sectors and mainstreaming industrialization, trade and service sector in the national development endeavors.

(4) Priority Sectors

1) To make the economic development sustainable, broad-based and poverty alleviation-oriented, emphasis will be given to the balanced development of the physical and social infrastructures taking into consideration the future federal republic state structure.
2) Priority will be accorded to employment creation and economic growth by providing priority to agriculture sector, tourism, industry, and export trade.
3) Investment will be increased to support development by promoting inclusion of excluded communities, region and gender in all structure, sector and processes of the nation.
4) To ensure availability and regularity of essential services for human livelihood (drinking water, energy/electricity, roads, communication, food security, health and education) the required investment in these sectors will be increased.
5) Emphasis will be given to ensure availability of quality services to the people on time and at concessional prices by promoting good governance.
6) Attention will be paid towards minimizing the impacts of climate change by protecting environment and availing opportunities.
7) High priority will be accorded to nationally important priority projects and those that will contribute directly to the relief of the people.

Table 2.1-1 Quantitative Targets of 3 Years Plan

| Indicators | Situation in FY2009/10 | 3 Years Plan's Targets |
|---|---|---|
| Economic growth rate (%) | 4.4 | 5.5 |
| Agriculture sector growth rate (%) | 3.3 | 3.9 |
| Non-agriculture sector growth rate (%) | 5.1 | 6.4 |
| Population living below poverty line (%) | 25.4 | 21 |
| Employment growth rate (%) | 3.0 | 3.6 |
| Population with access to drinking water services (%) | 80 | 85 |
| Primary level net enrolment rate (%) | 93.7 | 98 |
| Telephone including mobiles (per 100 people) | 27 | 55 |
| Electricity generation (installed capacity, mw.) | 691 | 972 |
| Population with access to electricity (%)* | 56 | 65 |
| Irrigation (hector) | 1,227,000 | 1,425,725 |
| Areas covered with forest (%) | 39.6 | 40 |
| Total length of roads (km)** | 19,447 | 20,122 |

Remarks: * Situation up to FY 2008/09, ** except rural roads.
Source: Three Year Plan Approach Paper (2010/11 – 2012/13), P.21, NPC

The current three-year development plan sets forth development strategies for key industrial sectors as economic development policy. The following outlines development strategies for agriculture, industry, trade, and tourism.

(5) Agriculture and Food Security

1) Efforts will be centered towards ensuring food and nutritional requirements by enhancing agriculture productivity through commercialization of agriculture and livestock commodities and development of rural infrastructure.
2) Enhance competitive capacity by making easy availability of improved breed livestock and reducing the cost of livestock production.
3) Make quality control, monitoring and regulation of food agriculture and livestock commodities effective.
4) Develop climate change resilience technology and to disseminate conservation, promotion and utilization of agriculture biodiversity.
5) Encourage organic agriculture
6) Coordinate research, extension and education
7) Encourage contract farming and cooperative farming
8) Develop and extend the agriculture market

(6) Industry

1) Focus on physical infrastructure, policies formulation and implementation necessary for small, medium and large industries to operate within the country
2) Expand business activity of micro enterprises at the national level by targeting poor and backward classes, and conflict-affected groups through using credit facilities of microfinance institutions, extending market for agricultural, non-timber forest and other natural resource, and utilizing traditional skills.
3) Make industries competitive and capable for maximizing the contribution of industrial sector in national economy through appropriate means, resources and facilities, production materials, energy, infrastructure and service delivery by ensuring necessary reforms in policies to improve investment environment.
4) Encourage non-resident Nepalese (NRN) to invest in Nepal for the protection, diversification, and promotion of foreign investment.

(7) Trade

1) Develop trade as an important engine for the national economy and enable it to compete at the international level.
2) Value add program in production and productivity will be conducted to improve the export capacity of goods and services and to achieve this, necessary support and facilitation will be provided.

3) Promote export by emphasizing the promotion of identified exportable goods, their marketing and establishment of value chain and also identifying and developing new exportable goods and services.
4) Strengthen the necessary infrastructure and institutional capacity in order to promote export, substitute import and diversity trade.
5) Mobilize foreign aid to promote export by increasing the competitive capacity of export trade.
6) Provide encouragement, facilities and concessions to the comparative advantage exportable goods and services for export trade promotion.

(8) Tourism and Civil Aviation
1) Develop the tourist industry as a base of the national economy.
2) Establish Nepal as a major tourist destination of the world.
3) Expand domestic tourist destinations and diversify tourism business.
4) Develop and expand physical infrastructures in tourism industry establishing cooperation between public and private sectors as well as with local communities and local bodies.
5) Attain balanced and inclusive development through tourism development providing significant contribution in employment generation, poverty reduction and regional balance.
6) Create conducive environment for tourism development.
7) Develop regional/international airports
8) Raise capacity of Nepal Airlines through management reforms of Airlines Corporation.

### 2.1.4 Immediate Action Plan on Economic Development and Prosperity

The Immediate Action Plan on Economic Development and Prosperity (IAPEDP) was prepared in January 2012 as an emergency plan by the National Development Problem Resolution Committee chaired by Prime Minister Bhattarai, based on the assessment of the past economic development plans executed by NPC and the current state of economic development. It was announced by the Ministry of Finance to specify actions to be taken urgently (in 2012/13) in social development measures in various sectors, timed to compile the fiscal 2012/13 budget. As it turned out, however, the plan was not implemented as intended due to the delay in budgeting to finance specified actions. Nevertheless, ten problems listed in the IAPEDP – as shown below - represent the government’s understanding of the country’s economic development conditions, thus providing information relevant and useful for this Study.

<u>Economic problems facing Nepal</u>
1) Low economic growth rates
2) Negative impacts of delay in development of physical infrastructure
3) Agriculture having structural problems relating to the inability to grow out of traditional techniques and minimum standards of living
4) Low levels of foreign direct investment

5) Insufficient infrastructure for tourism and promotional activity
6) Persistent increase in unemployment and minority workers
7) Slow pace of industrialization
8) Energy shortage
9) Vulnerability of the financial base
10) Spread of bribe and corruption

The five-year economic development plans, the three-year development plans, and the emergency plan in 2012 are well prepared, accurately addressing the issues facing the country and setting forth the goals to be achieved. Major problems lie in poor consistencies between basic policies and strategies set forth in these plans and programs planned and executed by line ministries, lack of coordination among ministries or other relevant organizations, and lack of strong leadership which makes budgeting for implementating individual programs a political game.

Policies and programs planned and implemented by ministries relating to economic development are discussed in later sections.

### 2.1.5 Immediate Economic Development Action Plan by FNCCI

FNCCI was announced in June 2012 as an economic emergency development plan named "Common Strategy for Sustainable Economic Growth (Common Minimum Agenda)", from the private sector point of view. This was based on the assessment of the past and current state of economic development in the country and sets forth strategies and goals for sustainable and long-term economic growth. And also, the Agenda indicated the prospective sectors which can directly influence growth in the economy. The vision and goals stipulated in it are as follows.

(1) Vision (20 years)

"Make Nepal a middle income country with a vibrant and sustainable economy growing at over 7 percent per annum"

(2) Short term goal (12-18 months)

1) Nepal will have the following new policies and related acts implemented:
   - Industrial policy
   - Trade policy
   - New FDI policy
   - New hydropower policy
   - Reformed BOOT policy
   - New Labor related Acts ensuring lab or flexibility and social security
2) One window mechanism functional
3) Identified 50 priority projects for foreign investment
4) A mechanism to acquire land for industrial and infrastructure development

(3) Medium term goals（5 years）

1) The overall investment as percentage of GDP will reach 35 percent and annual GDP growth rate to 7 percent per annum
2) Nepal will be creating around 300,000 new jobs every year
3) The industrial and commercial sector will enjoy uninterrupted power supply
4) At least 5 clusters with known field of Specialization and shaping the economy of the surrounding area will have emerged
5) Nepal will have started to function as a transit country for China South Asia trade
6) The policy and implementation hindrances of Public Private Partnership (PPP) will have been identified
7) A Dynamic and well-functioning market will have been in place with flexible labor policies, better access to finance and incentives for innovation

(4) Long term goals (10 years)

1) Nepal will have created 3.5 million new jobs over the next 10 years
2) Nepal will be a major business hub in South Asia linking major economies like China and India and will have a balance in trade (both goods and services)
3) The total population of Nepal will have access to uninterrupted electric power supply from national grid
4) All VDCs of Nepal will be connected by all-weather road
5) The overall contribution of agriculture sector to the GDP will be less than 15 percent and the share of population depending on agriculture will be less than 20 percent of the total population
6) The overall contribution of industry sector (manufacturing, mining, electricity, water and construction) to the GDP will be more than 30 percent and that of service sector will be more than 60 percent
7) The major market centers will be interconnected along with multiple accesses to market in neighboring countries through infrastructures like road and airport networks
8) Nepal will be well recognized as the best tourist destination in South Asia and tourism contributing over 10 percent of the country’s total GDP

## 2.2 Government Finance and Budget

### 2.2.1 General Outline of Government Revenues and Expenditures

Under the Nepalese government budget for fiscal 2011/12, expenditure (in the original budget) was set at Rs.384.9 billion and revenue at Rs.311.9 billion. The budget was increased from the previous year due to an expected increase in revenue. However, actual disbursement is made under the presidential decree, twice in July and December, because the political unrest continues to prevent deliberation at the national assembly[3]. The total amount of the 2011/12 budget grew by 25.7% over the previous year, with the ordinary expenditure totaling Rs.266.6 billion (up 12.5%), the capital expenditure Rs.72.6 billion (up 43.8%), and debt service Rs.20.3 billion (up 12.5%). The largest budget item is general administration (Rs.100.1 billion), followed by education (Rs.63.9 billion), agriculture, forestry and fishery (Rs.29.7 billion), and medical service (Rs.27.1 billion).

On the other hand, revenue sources were taxation Rs.209.2 billion (54% of the total budget), foreign grant Rs.70.1 billion, domestic loans Rs.37.4 billion, and foreign loans Rs.29.7 billion (see Table 2.2-1). Other revenue sources include user fee and penalty, gains from sales of public gods, dividends, royalty, and gains from sales of government assets.

Table 2.2-1 2011/12 Central Government Budget

| | Budget (Million Rupees) | | Proportion | | Percentage Change (%) |
|---|---|---|---|---|---|
| | FY 2010/11 Revised | FY 2011/12 Revised | FY 2010/11 Revised | FY 2011/12 Revised | |
| Total Budget | 306,270 | 384,900 | 100.0% | 100.0% | 25.67 |
| Expenditure | 269,642 | 339,220 | 88.0% | 88.1% | 25.80 |
| Recurrent | 219,160 | 266,613 | 71.6% | 69.3% | 21.65 |
| Development | 50,482 | 72,607 | 16.5% | 18.9% | 48.83 |
| Financial | 36,628 | 45,680 | 12.0% | 11.9% | 24.71 |
| Revenue/Grant | 253,245 | 311,907 | 82.7% | 81.0% | 23.16 |
| Tax | 181,255 | 209,203 | 59.2% | 54.4% | 15.40 |
| Non-Tax | 22,663 | 32,571 | 7.4% | 8.5% | 43.70 |
| Grant | 49,327 | 70,133 | 16.1% | 18.2% | 42.20 |
| Fiscal Balance | 16,398 | 27,313 | 5.4% | 7.1% | 66.56 |
| Fiscal Deficit Compensation | -14,344 | -27,314 | 4.7% | 7.1% | 90.42 |
| Loan to Public Institutions | 11,268 | 12,518 | 3.7% | 3.3% | 11.09 |
| Investment in Public Institutions | 4,885 | 6,930 | 1.6% | 1.8% | 41.87 |
| Foreign Debt | -2,821 | -15,995 | 0.9% | 4.2% | 467.00 |
| Domestic Debt | -27,676 | -30,767 | 9.0% | 0.8% | 11.17 |
| Under/Over (-) | 2,055 | 0 | | | |

Source: Public Statement of Income and Expenditure 2011/12, MOF

[3] After May 27, 2012 when the Consitutional Congress was dissolved, the congress is dysfunctional. As of January, 2013, general election was targeted to be held in June of the year. However, it is still uncertain if the target is met by the committed deadline.

As for tax revenues, VAT is the largest item to account for over 30% of the total, followed by income tax and customs duties representing around 20% each. In addition, excise tax is growing in recent years. The four taxes hold a combined share of 85%. After joining the WTO, the Nepalese government has been reducing product items subject to duties or lowering tariff rates, resulting in a significant decline in tariff revenue. Instead, the government has expanded excise tax from alcohol beverages and tobaccos to other commodities. Notably, for products for which the government would otherwise have imposed higher tariff rates, the government imposes excise tax to cause prices of the imported products to rise in the market.

The fiscal deficit continues in the recent ten years, despite the government efforts to reduce it. Table 2.2-2 summarizes the fiscal deficit trend since 2000. The deficit decreased in 2002/03 and 2004/05 but increased again afterwards. In 2010/11, it was equivalent to 3.6% of GDP. Despite the persistent fiscal deficits and stagnant local industries, the national economy manages to grow steadily thanks to the increase in remittance by overseas workers.

Table 2.2-2 Fiscal Deficit of Nepal

| Fiscal Year | Fiscal Deficit (Rs. In 10 million) | Proportion of Fiscal Deficit to GDP (In Percentage) |
|---|---|---|
| 2000/01 | 2,418.81 | 5.5 |
| 2001/02 | 2,294.06 | 5.0 |
| 2002/03 | 1,643.72 | 3.3 |
| 2003/04 | 1,582.82 | 2.9 |
| 2004/05 | 1,804.65 | 3.1 |
| 2005/06 | 2,477.96 | 3.8 |
| 2006/07 | 3,009.17 | 4.1 |
| 2007/08 | 3,340.67 | 4.1 |
| 2008/09 | 4,980.46 | 5.0 |
| 2009/10 | 4,119.74 | 3.5 |
| 2010/11 | 4,962.22 | 3.6 |

Source : FCGO and CBS

### 2.2.2 Local Government Finance

The local government system in Nepal is founded upon 3,995 Village Development Committees (VDCs) and 58 municipalities, above which there are 75 District Development Committees (DDCs). As VDCs and municipalities are positioned as local branches of DDCs, the former makes annual budget requests to the latter. In turn, each DDC submits budget requests and make necessary reports to its supervisory agency, the Ministry of Federal Affairs and Local Development.

The DDC's annual budget is called the District Development Fund (DDF) and is financed by sources specified under the Local Self Government Act. In addition, the DDC is entitled to receive special grant called the devolution from various ministries, including the MoH, the MoE, and the MoA. DDC's financial sources are roughly divided into grant by the central government and local revenues[4]. For example, in FY2010/11, the central government (MoF) disbursed a total amount of Rs.1.13 billion to DDCs, which were mainly used for local infrastructure projects, including irrigation, road construction, drinking water supply, and small-scale hydropower generation. In FY2011/12, the MoI made direct disbursement of Rs.2.3 billion.

On the other hand, each VDC received the VDC grant budget from the MoF, ranging between Rs.1.5 million and Rs.3 million[5]. The same grant budget – also ranging between Rs.1.5 million and Rs.3 million - was allocated in FY2011/12. More precisely, 605 VDCs received Rs.1.5 million each, 80 VDCs Rs.1.76 million, 1,704 VDCs Rs. 1.95 million, 1,060 VDCs Rs.2.15 million, 394 VDCs Rs.2.45 million, and 72 VDCs Rs.3 million.

As for municipalities, the central government introduced the local development tax in 1998/99, which replaced the previous Octroi (Chungj Car) and was collected at customs. It was designed to serve as a financial source for cost sharing between the central government and municipalities. In 2010/11, the total budget amounted to Rs.2,164 million, of which Rs.1,471.57 million were disbursed, consisting of Rs.1,078.32 million as projects funds and Rs.393.25 million as the recurrent budget covering salaries and wages.

Furthermore, the municipality grant of Rs.700 million was disbursed[6]. This was composed of Rs.599 million as project funds and the remaining Rs.111 million as the recurrent budget.

Note that local government finance at all levels (villages, municipalities and districts) is heavily dependent upon grants from the central government. In particular, salaries of local government heads and large projects are mostly financed by the central government. As the government budget is restricted to one third the original amount due to the dysfunction of the national assembly and disbursement to local governments is made toward the end of the fiscal year (four months before the yearend), it is very difficult to implement projects on schedule, resulting in persistent delay[7].

The central government's grants to local governments are either conditional or non-conditional. Conditional grants are mainly tied to specific projects. Use of non-conditional grants is monitored by the central government in terms of budget execution. Actual monitoring is

4 VDC, municipality and DDC budgets are accounted for in an annual report published by the Secretariat of Local Bodies Fiscal Commission.

5 The detail of the grant is defined in VDC Grant Operation Procedure 2009.

6 These grants for the Municipalities are provided in order to finance the projects approved by the central government.

7 From long time before, financial distribution from the central government to the local government tends to delay. Especially after 2007, the delay became more serious. It is related with the unstable government and the lack of understanding of rules regarding the descentralization.

conducted by a hired consultant using criteria called "Minimum Condition and Performance Measurement," which is based on 30 indices such as the poverty rate and the increase in population. Based on the level of goal achievement for each index, the subsequent year's budget will be determined.

58 municipalities receive the total budget of Rs.7.82 billion, with the average of Rs.120 million per municipality. However, the allocated amount varies greatly among municipalities according to their size. For instance, Kathmandu receives Rs.2 billion. Municipalities have their own revenue sources, including the garbage collection fee and the house license fee. Districts also have various revenue sources including the land license fee collected by the land tax office.

### 2.2.3 Issues relating to Improvement of Central and Local Government Finance

Nepal's fiscal condition, as measured by the ratio of revenue to GDP, improved from 11.6% in 2003/04 to 15.3% in 2010/11, partly due to the revenue management reforms and partly due to the reinforcement of tax collection capability relating to customs duties and VAT. Also, robust consumer spending fueled by the increase in remittance by overseas workers has led to revenue growth in the area of VAT. Meanwhile, government expenditure also increased but was compensated for by revenue growth and foreign aids, preventing the worsening of the primary balance. All in all, the ratio of public debts to GDP improved significantly from 59.4% in 2003/04 to 32% in 2010/11.

Nevertheless, detailed analysis of fiscal data indicates that the fiscal condition is still far from being healthy. Government revenue in 2010/11 totaled approximately Rs.216, 641,355,000, which covered only 64.1% of the total expenditure. The government still depends heavily on foreign aids, which are the largest financial source to make up the fiscal deficit. The country received multilateral and bilateral grants-in-aid worth Rs.65,324.33 million in 2010/11[8], which was equivalent to 19.3% of the total expenditure (Rs.33.79 billion). Also, the country obtained foreign loans totaling Rs.22,231,415,000 in the same year[9], equivalent to 6.5% of the government expenditure. Thus, 25.8% of the country's expenditure is financed by foreign aids and loans.

While major portions of the fiscal deficit are made up by foreign financial sources, the remaining deficit and the capital account deficit due to debt repayment are financed by local loans, which are made by issuing treasury bills (by the MoF) that are underwritten by banks compulsorily[10].

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[8] Bilateral grants-in-aid totaled Rs.29,485.42 million and multilateral ones Rs.35,858.81 million.

[9] Bilateral loans amounted to approximately Rs.5,867,404,000 and bilateral loans Rs.22,241,415,000.

[10] As for December 2012, the interest rate on the MoF-issued treasury bills was 0.765%. In comparison to bank deposit rates of around 3%, buying the treasury bill creates a significant back spread for banks that are required to bear financial burdens.

As of December, 2012, interest rate of short-term treasury bills underwritten by the private financial institutions were 0.765%. On the other hand, the deposit interest rate provided by the commercial banks were on the 3%. Thus, it was totally unconvenient deal for the banks. It leads to the increase of loan interest rates, and successively bank borrowers have to pay the costs.

Finally, the delay in budget execution that stems from the inactive national assembly presents a serious problem for government finance. At present, ministries and local governments cannot receive the whole amount of budget until the second half of the fiscal year, mostly a few months before the yearend. The situation makes it difficult for them to execute their budget in a planned manner, not to mention inefficient budget management.

## 2.3 Industrial Policy and Implementation System

### 2.3.1 Industrial Policy Framework

Nepal's industrial policy is founded upon five-year or three-year national economic development plans formulated by National Planning Commission (NPC), based on which sectorial development master plans and laws and regulations are established and enacted. Sectorial development master plans (development policies) are prepared by ministries responsible for individual sectors and are designed to show desirable directions of development and are regarded as policy guidelines. In addition, specific action plans (programs) and laws and ordinances that give legal authority for implementation are separately formulated and enacted. While the national economic development plans have been formulated every five or three years since the first five-year plan launched in 1956, sectorial development plans are not necessarily formulated annually or periodically. Rather, they have been newly formulated or updated on the basis of the policy guidelines set forth in five-year or three-year development plans.

Following the aggravation of the current account balance of payments in 1985, structural adjustment policy was implemented in cooperation of the IMF and the World Bank, and Poverty Reduction Strategy Paper was formulated in 2001. It was then adopted as an official development strategy paper and was compiled in 2003 as the 10th five-year plan. In the process, surveys on industrial development were conducted under the support of international donor organizations, and for some sectors, the corresponding survey reports including proposals and recommendations made therein are also considered as policy guidelines.

Major features and positioning of the national economic development plans are discussed in Chapter 2.1. Here, the relationship between the 10th five-year plan and sectorial development plans formulated by ministries is presented. First of all, primary goals set forth in the 10th five-year development plan are summarized as follows.

(1) To achieve GDP's growth rate of 6.2%, the agricultural sector 4.1% and the non-agricultural sector 7.5%, so as to reduce the percentage of the poor from 38% to 30%;
(2) To accomplish high economic growth with an emphasis on local economy;
(3) To provide basic social service in an effective manner and develop economic infrastructure;
(4) To mainstream the poor and women in the development process; and
(5) To achieve and maintain good governance.

The primary objectives of the 10th five-year plan – including "reduction of poverty," "equalized regional development," and "creation of employment opportunity" – is inherited to the ongoing three-year plan (2009/10 – 2012/13), based on which related ministries have formulated and implemented sectorial development policies and programs. For instance, Industry Policy 2010 formulated by the Ministry of Industry (MoI) sets forth the development goal of "reduction of poverty through industrial development. Trade Policy 2009 prepared by the Ministry of Commerce and Supply (MoCS) aims to reduce poverty through the reinforcement of the trade sector. Similarly, Tourism Policy 2008 established by the Ministry of Culture, Tourism, and Civil Aviation (MoTCA) aims to improve standards of living of rural areas through the development of local tourism resources. Clearly, these policies are positioned under the three-year national development plan.

To implement their development policies, ministries need to formulate action plans, prepare related laws and ordinances, and submit and negotiate on budget proposals. For instance, the implementation of Industrial Policy 2010 requires the enactment of the Special Economic Zone Act, together with legislation on the establishment of the One Stop Service Center and the Intellectual Property Protection Office and related budgetary allocations. (Note that the MoI has already submitted the above bills, which are waiting for parliamentary deliberation.)

Unfortunately, however, the national assembly is currently in suspension, thus blocking the authorization of industrial development programs prepared by ministries. Thus, Presidential Order or Development Order of the Cabinet substitutes the ordinary procedure to implement the public administration.[11] As pointed out earlier, the year 2012/13 budget, which commenced in mid-July, has been suspended for a while and it was late November when the budget for the remaining eight months was approved by the President. The approved budget only covers items under the previous budget, so that new programs are suspended without a prospect for budgeting.

### 2.3.2 Policy Implementation System

As discussed in page 1-4, Nepal's central government system consists of 26 ministries, which form the cabinet. Industrial development policies and programs are formulated and implemented by ministries in charge of relevant fields. While each ministry is responsible for policymaking, program development, and budgeting, its extra-departmental organizations implement programs. As this policy development and implementation process is consistent throughout the government, all the ministries consist of the same or similar sections including policymaking and evaluation. General organizations of three ministries that play a central role in industrial development, namely the MoI, the MoCS, and the MoCTCA, are described below.

[11] All the ministries rush for the Presidential Order to cope with the political deadlock. As a result, it caused additional delay for the administrative procedure. New Industrial Enterprise Act was approved by the Cabinet Order in January, 2013 and was unpromulgated in February of the same year.

(1) Ministry of Industry: MoI

1) Major role

The MoI is responsible for preparation of related bills, development and implementation of industrial development programs, and corporate registration as well as formulation of industrial policy. Major laws enacted and enforced by the ministry are as follows.

- Company Act 2006
- Insolvency Act, 2006
- Environment Protection Act, 1997
- Foreign Investment and Technology Transfer Act, 1992
- Industrial Enterprise Act, 1992
- Patent, Design &. Trademark Act, 1965

Programs are then implemented by the ministry's extra-departmental organizations, including Department of Cottage & Small Industry (DoCSI) and Cottage & Small Industry Development Board (CSIDB) that have regional offices[12]. Field survey by the study team of DoCSI offices in three zones, however, revealed that they were primarily conducting administrative service, such as company registration and small industrial development programs were limited to human resource development training covering specific trades and skills for around 200 persons per year. Their budgets seem to be fairly limited to expand the scale.

2) Ministry's organizational structure

The MoI has a Secretary, under which four Joint Secretaries are appointed to supervise the following four divisions (Figure 2.3-1).

- Administration &. Corporation Division
- Planning &. Policy Analysis Division
- Industrial Promotion Division
- Technology Division

Also, the ministry has the following extra-departmental organizations.

- Department of Industry

- Department of Cottage and Small Industry
- Cottage & Small Industry Development Board
- Department of Mines and Geology
- Department of Nepal Bureau of Standards and Metrology
- Office of the Company Registrar

[12] Among 75 Districts, DoCSI is in charge of 27 Districts, and CSIDB takes care of 48 Districts.

3) Department of Industry

The department, primarily in charge of medium-sized and large enterprises (not including commerce), consists of the following 6 divisions, including investment promotion.

- Registration and licensing Division
- Technology and Environment Analysis Division
- Foreign Investment and Information Division
- Industrial Property Division
- Planning and Monitoring Division
- Administration and Industry Facility Division

Two principal departments of Ministry of Industry is relevant in terms of industry development in Nepal among these departments. Thus, these departments are analyzed below.

4) Department of Cottage and Small Industry (DCSI) and Cottage and Small Industry Development Board (CSIDB)

Both organizations provide administrative service covering cottage and small industries as the MOI's extra-departmental organizations. DCSI is responsible for 27 districts and CSIDB the remaining 45 districts. While DCSI covers a smaller geographical area than CSIDB does, the former's jurisdiction accounts for around 70% of cottage and small industries operating in the country due to relatively high industrial distribution and population density, and the latter's the remaining 30%. As for budget allocation, CSIDB receives a larger amount because their office is located in every district and assigns staff. The field survey suggests that they have so far been playing a primary role of administrative service provider, such as company registration, rather than organizations to implement policies and programs benefitting cottage and small industries.

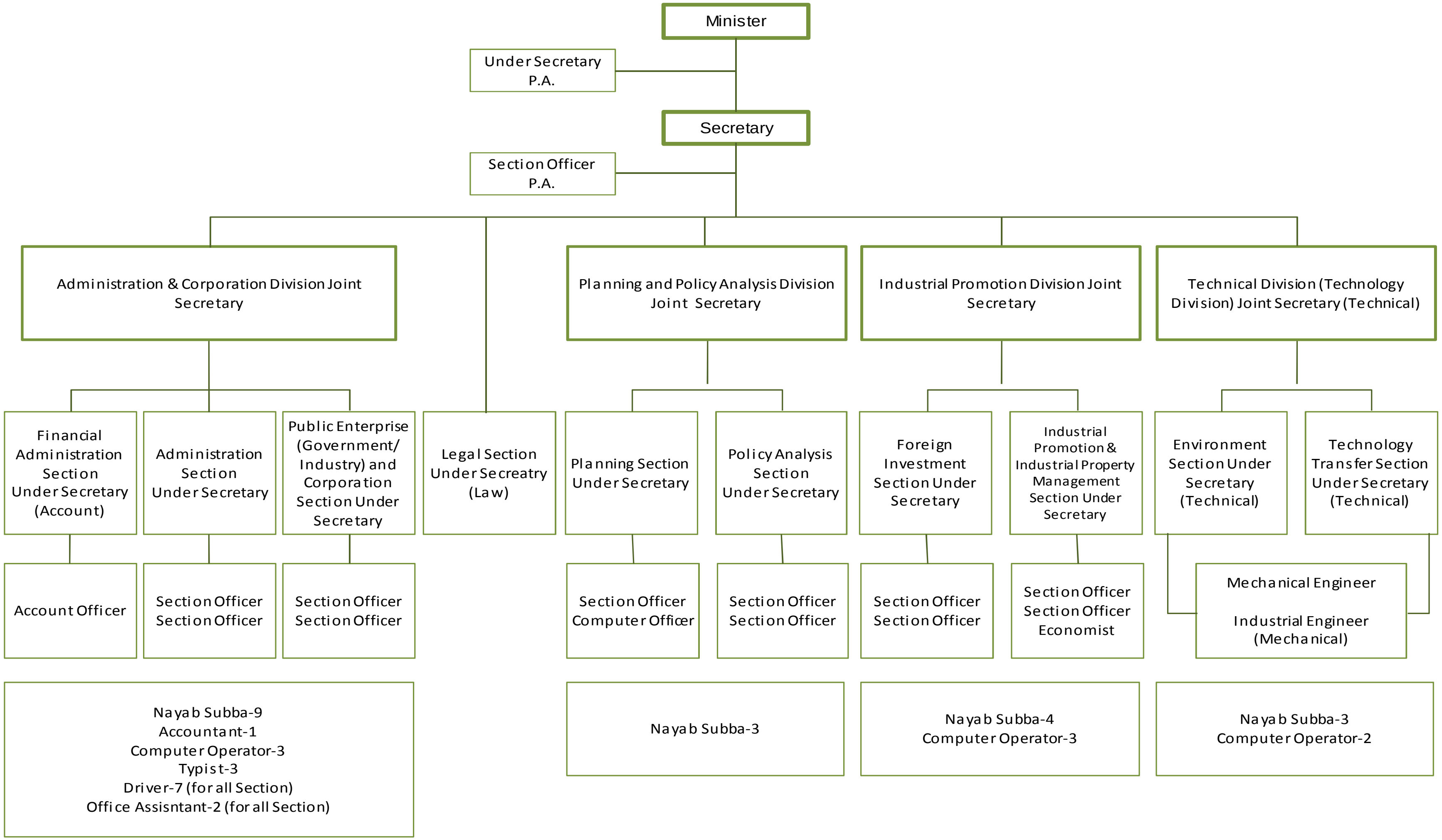



Figure 2.3-1 Organizational Chart of Ministry of Industry

(2) Ministry of Commerce and Supplies: MoCS

1) Major duties

- Formulation and implementation of trade policy
- Export promotion
- Issuance and maintenance of licenses permitted under regulations
- Registration, management and streamlining of export documentation
- Distribution of imported goods
- Promotion of the business environment conducive to the private sector's initiative and activity
- Monitoring and analysis of domestic market prices
- Monitoring and analysis of international market prices (India and other third countries)
- Monitoring of supply conditions of necessities and reporting to related authorities

2) Organizational structure

As shown in Figure 2.3-2, the ministry has three Joint Secretaries, who supervise 3 divisions and 10 sections. Also, the MoCS has offices in Kolkatta (the largest gateway to third countries other than India for trade) and Geneva, Switzerland (in relation to WTO and other international trade affairs). Note that "Supplies" in the ministry's name comes from the fact that it supervises the following state-operated trading companies handling a variety of materials and goods:

- National Trading Limited
- Nepal Food Corporation
- Salt Trading Corporation
- Nepal Oil Corporation
- Nepal Transit and Container Management Co., Ltd.

Among these national companies, National Trading Limited and Nepal Food Corporation are explained below.

National Trading Limited (NTL)

NTL is a state enterprise specialized in international trade and was established under the Company Act in 1962 with the primary mission to import and market aid commodities from China and the former Soviet Union in the country. It has then expanded business to imports of restricted products from India, imports of construction and industrial materials and machinery, and price control of imported products in the country. At present, it handles imports and sales of consumer goods, liquors, perfumes, tobaccos, cement, salt, and sugar and operates duty-free shops at the country's international airports. On the other hand, its mandated roles of promoting smooth distribution of industrial materials in the country and controlling domestic prices of imported goods have been significantly fading due to the emergence of a large number of private trading companies. In particular, price control is largely left to a market mechanism, and NTL's principal role is limited to emergency imports and supply of consumer goods for which demand surges during the holiday seasons so as to prevent price hikes in the local market.

National Food Corporation (NFC)

NFC is a state enterprise established for the primary purpose of procuring (including from the local market) and stockpiling grains, edible oil, and mutton, and of distributing food in rural areas. It maintains food storehouses in around 30 locations throughout the country. It purchases grains from rural farmers, mainly in the Terai region, and is responsible for transportation of food that is to be supplied to mountainous areas. As Nepal has still to achieve stable supply of staple food, including rice, wheat, corn and edible oil, the government is expected to play a crucial role of ensuring emergency supply in the case of local shortage and of maintaining price stability, from the perspective of warranting people's livelihood. Also, NFC continues to make significant contribution to the country's food imports and exports, although its importance is declining due to an increasing number of private traders. For instance, it is responsible for the receiving and distributing of rice supplied by Japan as commodity aid.

As for the MoCS, extra-departmental organizations are as follows.

- Department of Commerce and Supply Management
- Trade and Export Promotion Center

Trade and Export Promotion Center (TEPC)

TEPC was established in November 2006 by merging three different organizations – Trade Promotion Center, Export Promotion Board, and Carpet & Wood Development Board – to become a government organization in charge of trade promotion. Its current activity is primarily related to information gathering, including the compilation of trade statistics and trade surveys, while export promotion activity is limited to support for participation in trade fairs (see 4.3.1 for detailed analysis of TEPC). It has still to play an expected role partly because of budget constraint (around Rp.16 million per year) and partly because of a 40% decline in the number of staffs in comparison to that at the time of establishment.

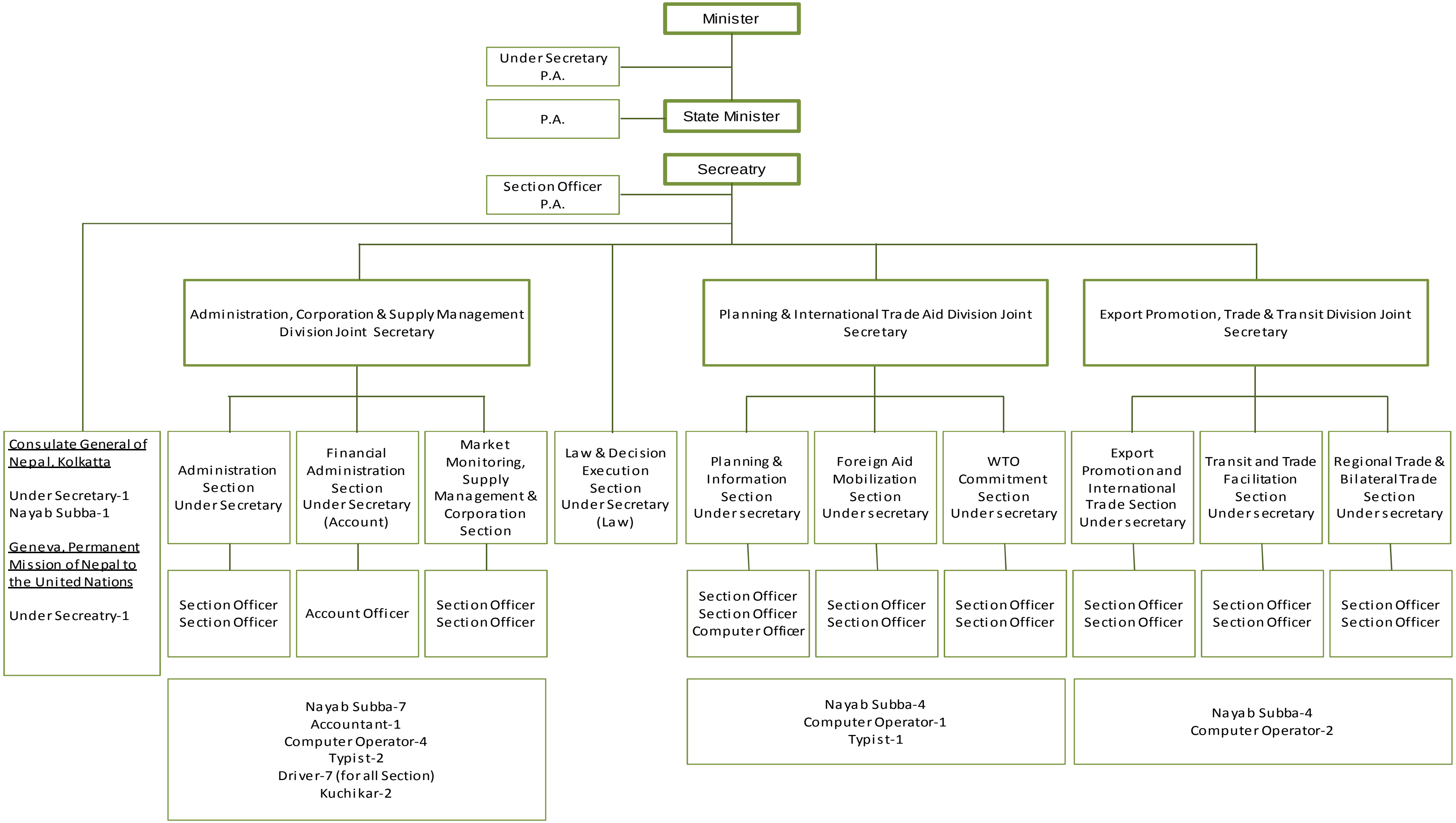



Figure 2.3-2 Organizational Chart of Ministry of Commerce and Supplies

(3) Ministry of Culture, Tourism and Civil Aviation: MoTCA

1) Major duties

The MoTCA is responsible for protection of cultural heritages and supervision of civil aviation, in addition to formulation of tourism policy and development plans including long-term development visions such as Vision 2020. The ongoing program to divide the country into 18 tourist zones and hold an annual campaign for each zone alternately is originated from the long-term vision.

2) Organizational structure

As shown in Figure 2.3-3, the ministry's policymaking in the three principal areas is made by a single division. Tourism Industry Division is divided into 3 sections, i.e., hotels/restaurants/travel, trekking and mountaineering, and tourist police. Note that activities to attract tourists, including campaigns and advertisement, are conducted by the ministry's extra-departmental organization, Nepal Tourism Board (NTB).

3) Nepal Tourism Board (NTB)

NTB was established in 1998 as an organization to promote tourism, under the partnership between the Nepal government and the private sector. It has around 60 staff members and operates the head office in Kathmandu, a branch office in Pokhara, and tourist centers in four local airports. It is primarily mandated to conduct promotional activities to attract tourists, but it also intends to develop tourism resources in the future. The board of directors, consisting of 11 members, is headed by the MoTCA's Secretary.

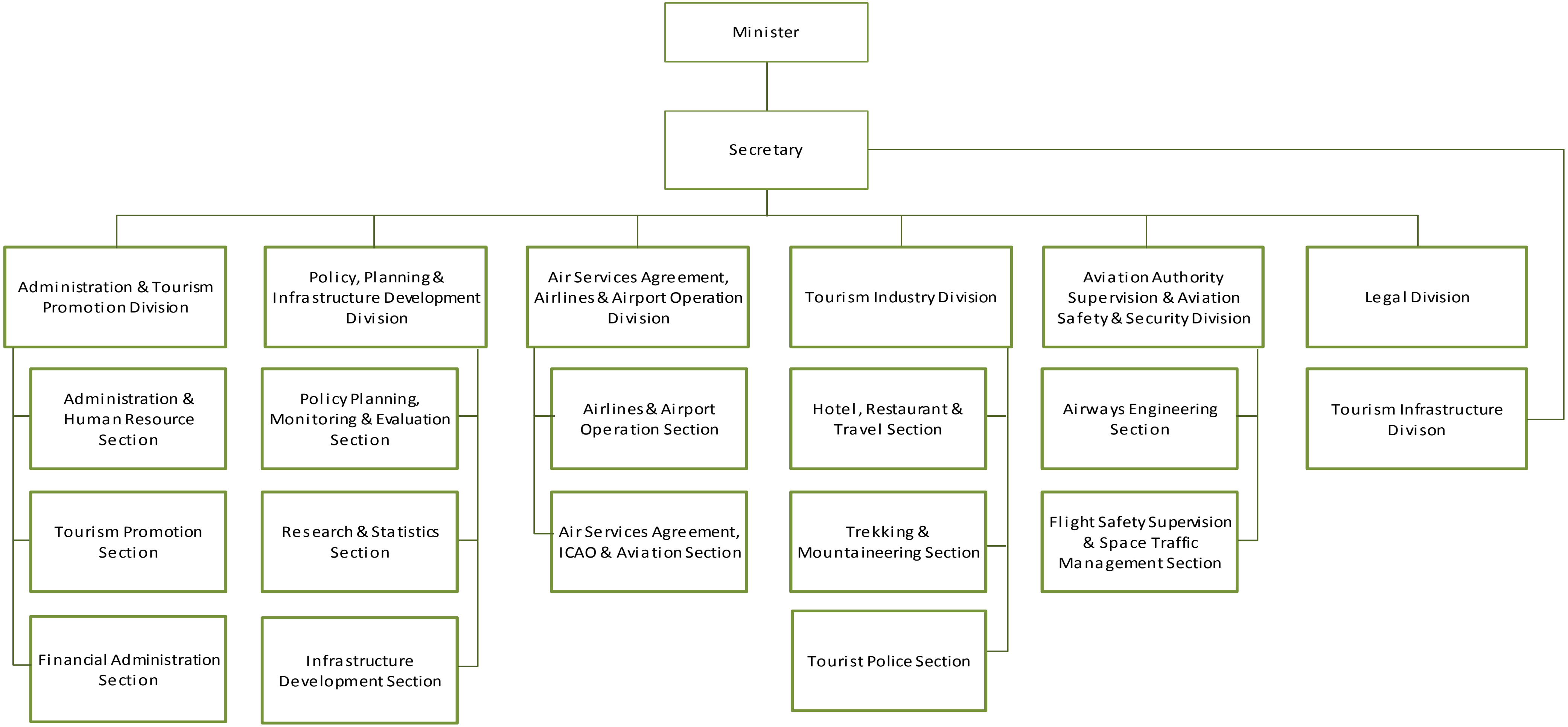



Figure 2.3-3 Organization Chart of Ministry of Culture, Tourism and Civil Aviation

### 2.3.3 Function and Role of Economic Organizations

Major economic organizations in Nepal are as follows. All of them have a nationwide organization and most companies and individuals conducting business in the country (except for those in the informal sector) seem to belong to one of them.

(1) Federation of Nepal Chamber of Commerce & Industry (FNCCI)

FNCCI is the country's largest economic organization established in 1965 under the National Directives Act 1961. It consists of around 450 major enterprises, 92 local chambers of commerce and industry at district/municipal level, 80 at sectorial/commodity level, and 11 bi-national chambers of commerce and industry. Its corporate membership is estimated to total around 100,000 (no exact number has been accounted for). As there are as much as 35,000 manufacturing establishments in the country, including rice mills, most of them seem to be included in FNCCI. FNCCI has the head office in Kathmandu, which has around 70 staff members, and has branch offices in 72 districts. Thus, it is considered to represent the country's industry.

FNCCI's activities can be classified into the following four categories: (1) lobbying activity as an economic organization at national level; (2) business promotion by forming and extending networks with related organizations in and outside the country; (3) implementation of support programs, mainly human resource development; and (4) the issuance of the certificate of origin. These activities cover a broad range of fields, from promotion of infrastructure and other national-scale projects to support for local development programs such as "one district one product movement[13]," while extending to international collaboration. FNCCI's annual budget amounts to around Rp.150 million, half of which comes from the fee charged for the issuance of the certificate of origin.

Because of its large size that includes a wide variety of shareholders representing diverse industries and business interests, FNCCI is not facing difficulty in focusing its industrial development efforts and resources[14]. Also, its large organization results in a slow decision making process. Furthermore, its lobbying activity does always not produce sufficient results due to the difficult in establishing or maintaining good connection with the government caused by political instability. It needs to overcome these challenges that are often found a large organization.

[13] OVOP（One Village, One Product） is led by Ministry of Agriculture and Cooperatives in the limited places. On the other hand, ODOP（One District, One Product）is guided by the FNCCI. It is developed and diffused to the broader area based on OVOP. FNCCI focuses on district rather than villages since the village is too small to promote the project in Nepal. There are 2,900 Village Development Committee which consist of 6 to 10 villages in the country. They also participate in ODOP.

[14] FNCCI corroborate "Minimum Economic Agenda" and work with the government. This long-term development proposal focuses on Tourism, Hydro power generation, Agriculture, Social Capital, Trade and Education.

(2) Confederation of Nepalese Industry (CNI)

CIN was established in April 2000 as separated from FNCCI. It differs from FNCCI in that its membership solely consists of medium-size and large enterprises in the manufacturing, finance/service, and construction industries, thus not including companies in the commerce sector that represents the majority of FNCCI. CNI has 175 member companies and has 7 branch offices throughout the country. With the primary purpose of improving competitiveness of the Nepalese industry and making contribution to the country's economic development, it proposes policies to the government and is engaged in industrial promotion activity, mainly by the form of lobbying. Also, it cultivates cooperative relationship with the World Economic Forum (WEF) and the Confederation of Indian Industries (CII) as the representative of economic organizations in Nepal.

Notably, CNI is ardently conducting activities in the area of trade and investment promotion. Since December 2012, it has been operating the "Invest Nepal" Web site to provide information for potential investors under USAID's financial support and in collaboration with the MoI. The site is serving as an excellent source of information in English, not seen in the similar past attempts in terms of quality and content. Furthermore, CNI plans to launch a grand project to develop the country's 10 export items (including tourism) to international brands and to provide support for exploration of the European market, under EU's support (scheduled to start in April 2013). Thus, CNI is fully committed to the country's industrial development by making a variety of initiatives that include those that could be undertaken by the government.

CNI's financial sources are mainly entrance and annual fees paid by member companies, but it does not have a permanent revenue source in the case of FNCCI (the fee for issuance of the certificate of origin). It thus has policy to promote industrial development projects by using financial support of donor organizations including USAID and EU. Note that CNI's entrance fee is Rp.250,000 and annual fee Rp.100,000 or 200,000 for regular members, very high in comparison to other economic organizations, which suggests strong commitment of its members. As the government is unable to initiate effective programs to support industrial development due to political instability, CNI stands out as a reliable organization with firm leadership and initiative.

(3) Nepal-India Chamber of Commerce and Industry (NICCI)

NICCI was established in 1994 for the primary purpose of promoting trade in India. In the 1990s, the business relationship between Nepal and India, including investment, reached its peak, and trade with India still accounts for over 60% of Nepal's total trade volume today. Originally, NICCI's members included Indian companies. To become its member, annual sales of Rp.25 million or higher are required. The current membership is around 100 companies, which decreased from original 170 companies as a result of increased resignation of companies with poor performance. In terms of trade, the membership is dominated by manufacturers in the food, soap/pharmaceutical, and textile sectors, including joint ventures with India. Most member companies are also FNCCI or CIN members, reflecting their intention to benefit from lobbying activity specialized in the business relationship with India. NICCI's operating budget mainly comes from membership fees and is in part financed by revenue relating to the issuance of the certificate of origin, which is carried out on behalf of FNCCI. Its head office is located in Kathmandu and only one branch office in Biratnagar.

NICCI's activity is limited to the reinforcement of trade and business relationship with India (including investment), ranging from provision of information on the Indian market, the sending and receiving of trade missions to and from India, lobbying activity to eliminate or reduce barriers for trade between the two countries, and publication of periodicals. In particular, NICCI assumes a leading role in lobbying for solution of problems relating to the Nepal-India trade, including illegal trade (conducted by residents residing along the border or organizations), unfair tariff rates (most products imported from India to Nepal are subject to tariff, while products made by processing materials imported from India are tax exempted when they are exported to India), and trade practice taking advantage of different tariff rates imposed by the two countries on products exported or imported to and from third countries. Note that, although NICCI is specialized in the development of economic relationship with India, it is not engaged in investment promotion, such as intermediary service for potential joint partners in the two countries.

(4) Federation of Nepal Cottage and Small Industries (FNCSI)

FNCSI is an economic organization composed of cottage and small industries. It serves as a national organization for local organizations, district chapters, located in 74 out of 75 districts throughout the country, and FNCSI's member companies are a member of a district chapter. FNCSI membership also include members of 14 commodity associations (mainly consisting of cottage and small industries) as well as Women Entrepreneurs Committee (WEC) that is established in 52 districts. An exact number of FNCSI member companies are not known, while it is estimated that 10,000 to 20,000 member companies are actually operating business. In 55 out of 74 district chapters, Entrepreneurs Committee is established, but there is no local organization at the village level to prevent accurate estimation of membership. FNCSI's main revenue source is the membership fee, which is not collected fully due to the absence of a membership record or list.

While FNCCI includes cottage and small industries as members, FNCSI is basically an assembly of business persons and small enterprises. Its management board consists of 49 directors elected from 34 districts (to be increased to 60 in the near future). However, it is sometimes criticized that many of the directors live in the Kathmandu capital region and the board is thus unable to understand and translate the needs of rural industries to effective lobbying activity. In particular, many FNCSI member companies face difficulty in continuing their business and strongly need financial assistance. As the government fails to provide effective support for cottage and small industries, while it gives policy priority to investment and export promotion and general support for the poor, FNCSI is expected to play a complementary role but is far from fulfilling it. It is important to recognize that FNCSI is only one entity that is in a position to represent the interests of cottage and small industries through lobbying activity.

FNCSI provides the administrative, technical and financial supports to its affiliates. Regarding the financial supports, FNCSI facilitates to coordinate 28,000 cooperatives and gain the financial access. 32 commercial banks, 16 development banks and some financial corporation provides small and medium enterprise finance. However, loan provision with Grameen Loan method is limited to the small amount.

## 2.4 Current State of Economic Cooperation Agreements

### 2.4.1 WTO membership

On April 23, 2004, Nepal became the 147th member of WTO. This marked the first of the 49 LLDCs that became the WTO member and indicates the country's firm intention and effort to participate in the global trade mechanism. The country's strong commitment to WTO is reflected in the fact that the Nepalese government maintains one of its two trade-related external offices in Geneva[15]. As its major trade partner, India, is the original member of WTO at the time of its establishment in January 1995, and the country's major export markets for textile and garment, pashmina, and carpets are the U.S. and Europe, the country needed to participate in WTO by meeting the membership qualifications. In reality, however, required elimination or reduction of trade barriers as a WTO member imposes heavy burdens on the country's exports of both industrial and agricultural products, and the country has still to fully benefit from the membership.

Clearly, promotion of economic liberalization and globalization incurs substantial cost for Nepal that does not have a fully competitive industrial base and investment climate. For instance, it has a large number of negative list items that are subject to import tariff. As for investment promotion, the country is still unable to take advantage of favorable conditions created by the WTO membership due to internal factors, including political instability and power shortage. At present, the government is moving in the direction of promoting trade by using multilateral and bilateral trade agreements, but it is highly desirable to develop international trade of value added, industrial products within the framework of WTO, thus establishing a successful model for other LLDC that uses the WTO membership as a springboard for economic development.

### 2.4.2 Multilateral and Regional Trade Agreements

Nepal has established multi-faceted cooperation mechanisms in South Asia, namely South Asian Free Trade Area Agreement (SAFTA), Bay of Bengal Initiative for Multi-Sectorial Technical and Economic Cooperation (BIMSTEC), and South Asian Association for Regional Cooperation (SAARC).

(1) SAFTA

1) SAFTA Member nations of SAARC, which had been inaugurated in 1985, signed the SAFTA in January 2004, which was a ramification of South Asian Preferential Trade Agreement and became effective in January 2006 after the ratification by the member countries. Nepal was late for signing and joined it in August 2006. SAFTA aims to integrate economies of the member nations into a free trade zone, starting on January 1, 2016. Toward the goal, India,

[15] Another external office is the government's commerce office located in Kolkata, India

Pakistan and Sri Lanka have agreed to reduce tariff rates to 20% by January 2008 and to 0-5% by January 2013. Bangladesh, Bhutan, Maldives, and Nepal have pledged to lower their tariff rates to 30% by January 2008 and to 0-5% by January 2016. In addition, India, Pakistan, and Sri Lanka have agreed to reduce tariffs on imports from Bangladesh, Bhutan, Maldives, and Nepal to 0-5% by 2009. However, the tariff reductions are not applied to "sensitive" products, and some countries including Nepal and Pakistan are criticized for a large list of sensitive items.

(2) SAARC

SAARC was created in December 1985 for the purpose of social, economic and cultural development. Original member nations were Sri Lanka, Bhutan, India, Maldives, Nepal, Pakistan, and Bangladesh. In 2007, Afghanistan became a member. In addition to annual summit meetings, the foreign-minister level talks are held twice a year. In August 2010, South Asian Association for Regional Cooperation (SAARC) Agreement on Trade in Services was signed to further deepen the integration of the regional economies. SAARC's Secretariat is based in Kathmandu.

(3) BIMSTEC

Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC) became effective in 1997 and functions as a forum to promote and streamline technical cooperation, trade and investment among its member nations. In addition to the five SAFTA member nations (Bangladesh, Bhutan, India, Nepal, and Sri Lanka), two ASEAN nations (Thailand and Myanmar) are members. BIMSTEC was originally conceived to integrate Thailand's Look West policy and India's Look East policy and was inaugurated by four members, i.e., Thailand, India, Bangladesh, and Sri Lanka. Later, Myanmar, Nepal and Bhutan joined. Nepal participated as an observer in 1998 and became a formal member in 2004.

In 2004, the BMISTEC member nations agreed to establish the Free Trade Area Framework Agreement in the fields of goods, services and investment. At present, discussions on tariff exemption and reduction on goods except those specified in negative lists for developed countries (India, Sri Lanka and Thailand) as well as for less developed countries (Bangladesh, Bhutan, Myanmar, and Nepal) are underway separately. In practice, however, as efforts to strengthen the organization and function of SAFTA do not produce significant results, coupled with the difference in opinions among the member nations about BIMSTEC and its development, little progress has been made as to the effective working of the initiative.

### 2.4.3 Bilateral Trade Agreements

(1) Current state

Nepal has signed bilateral trade agreements with 17 countries, some of which have lost effect. In addition to the trade cooperation agreement with the EU, the country has signed the Generalized System of Preferences (GSP) agreement with Belarus, Canada, the EU, Japan, New

Zealand, Norway, Russia, Switzerland, Turkey, and the United States. Note that the country has not joined the Global System of Trade Preferences (GSTP) between less developed countries.

The bilateral trade agreement has been concluded with the following 17 countries[16]: Bangladesh (1976); Bulgaria (1980), People Republic of China (1981), Czech Slovakia (1992), North Korea (1970), Egypt (1975), India (1991), Mongol (1992), Pakistan (1982), Poland (1992), South Korea (1971), Rumania (1984), Sri Lanka (1979), the United Kingdom (1965), the United States (1947), Russia[17] (1970), and Yugoslavia (1965).

These bilateral trade agreements provide preferential treatment and basically cover all items, although some of them have become null and void afterwards[18]. The trade cooperation agreement with the EU was concluded on November 20, 1995. On the other hand, little talk has been done within the government as to a trade agreement with Japan, which thus has no prospect for conclusion in the near future.

(2) India-Nepal Trade Agreement

Nepal signed a trade agreement with India – Nepal's largest trade partner, in 1991, which became effective immediately, under the agreement, imports of primary products for both countries, in principle, are exempted from customs duties[19]. Furthermore, India exempts tariff for imports from Nepal under the conditions of 30% valued added and modification of custom code numbers to 4 digits. The current trade agreement reflects India's strong intention to support Nepal's industry. Its period was extended for 7 years, effective on October 23, 2009. At present, the Indian government is proposing the start of negotiation on a Comprehensive Economic Partnership Agreement (CEPA) including service trade and investment. Bilateral Investment Promotion and Protection Agreement (BIPPA) was signed in October, 2011.

[16] The figures in the parenthesis after each country name denotes the signing year.

[17] The former Soviet Union (USSR)

[18] For instance, bilateral trade agreements with Bulgaria, Poland and Rumania lost their raison d'etre when these countries joined the EU.

[19] Simultaneously, several treaties and agreements were signed with India in 1991. Officially, it is called India-Nepal Treaties of Trade, Transit, and Agreement for Cooperation to Control Unauthorized Trade.

## 2.5 Current State of Development Assistance and Support by International Donor Organizations

This section outlines activities of major donor organizations that aim to promote development of the private sector in a variety of fields, including international trade, investment, financial access, vocational training and business startup. Organizations discussed are multilateral organizations, namely the World Bank, International Finance Corporation (IFC), Asian Development Bank (ADB), United Nations Development Programme (UNDP), UN Capital Development Fund (UNCDF), and bilateral aid organizations, namely Department for International Development (DFID), US Agency for International Development (USAID), and Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ).

### 2.5.1 Assistance and Support by Multinational Organizations

(1) The World Bank/ International Finance Corporation (IFC)

1) Project for Agriculture Commercialization and Trade (PACT)

The World Bank's PACT aims to improve competitiveness of small farms and the agri-business sector by providing farmer groups and cooperatives with support for market-oriented production activity, furnishing them with technology and information required to improve market access, providing assistance in development of public infrastructure, and supporting development of agri-business. At the same time, PACT provides support that leads to the reinforcement of value chains by promoting close relationships among producers, traders and processors as well as the reduction of trade barriers by building the ability to comply with food safety and hygienic standards required by local and international markets. PACT in Nepal originally covered 25 districts and is now deployed nationwide.

2) Enhanced Vocational Education and Training

The World Bank's Enhanced Vocational Education and Training Project has the primary objective of increasing the labor force with an appropriate set of skills that meets the actual needs of industry, by reinforcing the vocational education and training system to provide high quality education and training. It consists of the following four components: (1) support for improvement of the institutional environment for the technical education and vocational training (TEVT) subsector, including government policy and regulation; (2) reinforcement of technical education at the Technical School Leaving Certificate (TSLC) and diploma levels conducted at vocational training institutes of the Council for TEVT (CTEVT), affiliated vocational training institutes, and community colleges; (3) support for certification of skills acquired from short-term vocation training or through an informal learning process other than vocational training; and (4) program monitoring and evaluation.

3) Nepal Investment Climate Reform Program

This program is undertaken by IFC with participation of DFID for the primary purpose of improving the country's investment climate. It consists of the following three elements: (1) the establishment of the Nepal Business Forum (NBF) as a framework for dialogue between the public and private sectors; (2) support for institutional reforms to reduce business costs; and (3) support for streamlining of cross-border trade procedures. Originally, it also provided support for promotion of investment in SEZs by improving the related system and institution, which requires statutory changes. In light of the political deadlock to prevent the enactment of acts, it is now replaced with the streamlining of cross-border procedures. The program period will end in 2014, but five-year extension is planned.

4) Ventures Nepal (Venture Capital Fund)

Ventures Nepal was established by IFC for the purpose of promoting the development of the private sector. IFC contributed $7 million to the fund. It provides risk capital, up to $500,000, for small companies with annual sales and assets of $3 million or less each and less than 50 employees – in particular, those that have high growth potential but cannot borrow from banks due to the lack of collateral, for the maximum period of five years. Furthermore, it provides advisory service for its borrowers, such as marketing strategy, to support their growth, while training fund managers. It continues assistance until it collects funds.

5) Support for implementation of PPP-based infrastructure development projects

IFC provide support for Nepal Investment Board with regard to the development of institutional, organizational, and policy frameworks for infrastructure development projects using the PPP scheme. Using its own experience in other countries, IFC undertakes a variety of support activities, including capacity building of stakeholders, improvement of the investment climate, provision of sample documents required for initiation of PPP, identification of projects suitable for the PPP scheme, and management of the tender process undertaken for the PPP scheme.

In addition, the World Bank implements a variety of support programs to improve the business environment for the financial sector, ranging from creditworthiness analysis of financial institutions (for the central bank), the development of a framework for dissolving troubled banks, formulation of a long-term financial sector development strategy, budgetary support subject to both the improvement of financial sector-related policy (in particular, amendment to the Central Bank Act) and the enactment of the Deposit Insurance Act. For private banks, the World Bank makes capacity building efforts relating to compliance with International Financial Reporting Standards (IFRSs) and expansion of loans to the agricultural sector (for Nirdhan Utthan Bank Ltd. (NUBL)). On the other hand, IFC provides technical support in a number of areas, including technical support for credit bureaus, development of an official registry of movable properties as collateral, support for service expansion of two microfinance institutions to remote areas, and technical support for promotion of loans to female entrepreneurs.

(2) Asian Development Bank: ADB

1) Support for Formulating an Economic Development Vision

In response to the Nepalese government's request, ADB provides assistance in formulation of a long-term economic development vision, as part of its program "Support for Formulating an Economic Development Vision." ADB will prepare a synthesis report that identifies issues and opportunities for economic development in Nepal, send it to prominent development economists, and hold an economic summit under their participation. Based on discussion at the summit, a long-term economic development vision and a draft medium-term development plan will be formulated. It is planned to hold the economic summit by September 2013, but preparation does not progress due to the political unrest and it is not certain as to when it can be held.

2) Preparation of the Agricultural Development Strategy

Similarly, ADB provides support for formulation of a country's agricultural development strategy.

3) South Asia Subregional Economic Cooperation Trade Facilitation Program

Although free trade agreements have been signed in South Asia, intra-trade as percentage share of overall trade made by member countries remains at a much lower level than other FTA regions. A major reason for this is said to be the presence of informal trade. To promote regional trade, the South Asia Subregional Economic Cooperation Trade Facilitation Program provides support for three member countries (Bangladesh, Bhutan, and Nepal) of South Asian Growth Quadrangle (SAGQ) that aims for sustainable economic development, in order to invigorate intra-trade. Although India is also a member of SAGQ, it carries out reforms for intra-trade promotion at its own cost and is thus not covered by the program. The program is designed to help the three countries to achieve the following goals in relation to cross-border trade: (1) modern and effective administration of customs service; (2) simple and transparent regulation and procedures; and (3) improvement of information service for the private sector.

4) Skill Development Project

ADB plans to provide support in the area of vocational training and conducts a preliminary study covering the organization of the vocational training subsector, information and data on trainees and instructors, course design, and adaptability to the market needs, which will be used as the basis of planning and implementing the actual support program.

(3) United Nations Development Programme: UNDP

The UNDP has been undertaking Micro-Enterprise Development Programme (MEDEP) in Nepal since 1998, which aims to reduce poverty by encouraging business startup by low income population, especially women, the youth, and Dalits. It now covers 38 districts. The program provides a wide variety of services required to support low income people in the startup process, including selection of eligible persons through household survey, selection of prospective products and services in consideration of locally available resources and on the basis of a market needs survey, education and training of technical and management skills required for business startup, and mediation between entrepreneurs and micro-finance service providers. The UNDP has also developed, jointly with the Council for Technical Education and Vocational Training (CTEVT), a training program for enterprise development facilitators who carry out the above services and activities, together with the training of business development service (BDS) providers in each district. So far, three-fourths of households that have received support under the program have reportedly gone out of poverty and approximately 80% of the businesses launched under the program continue. And successful cases have emerged, such as cultivation and export of off-season vegetables to India, and export of soaps using a herb, Cyuri, to Japan.

The above methodology for business startup support using the MEDEP model has also been adopted by Department of Cottage & Small Industry (DoCSI) and Cottage & Small Industry Development Board (CSIDB), which intend to provide similar support as Micro-Enterprise Development for Poverty Alleviation Scheme. The program is expected to continue after completion of the present support phase, and in the next phase, the program's focus will be shifted to capacity building for stakeholders in villages, districts and the central government, who are responsible for management of the business startup support program, together with facilitators and BDS providers, with an aim to transfer program responsibility gradually to DoSCI and CSIDB.

(4) UN Capital Development Fund: UNCDF

1) Access to Financial Services

The program was implemented by UNCDF, jointly with UNDP, to help financial service providers to extend their service to villages and remote areas and ended in December 2012. Under the program, target areas for program support and 18 financial service providers were selected, and financial incentive was provided for a service provider who obtained customers at a newly established branch office in a target area, so as to reduce the business cost relating to the establishment of the branch office. At the same time, UNCDF provided education and training on micro-finance service to enable financial service providers to provide efficient and broad service, including non-collateral loans – especially, Grameen Bank type microfinance service – for business operators in village and remote areas.

Under a program of UNCDF, a financial institution that wishes to participate in it submits a business plan. Upon UNCDF's approval, it becomes a program implementation partner that is eligible to receive technical support relating to program implementation, a small amount of fund to finance the launching of program activity, and provision of an additional fund according to the actual results.

2) Value Chain Finance

This program, which is currently in the planning stage, aims to reinforce competitiveness of three products, namely tea, ginger, and dairy products by providing financial service for business operators in each value chain (including farms, traders, wholesalers, and retailers), thereby to eliminate or reduce factors that impede effective working of the value chain. For instance, if there is no proper storage facility for tea leaves to keep them in good condition before being shipped to a processing factory, the program will extend loans to build the storage. Financial service will be provided by a microfinance service provider or a commercial bank, depending on the actual needs of business operators. The program will be implemented under technical support of Danish International Development Agency (DANIDA), for the period of 4-5 years. (Note that this program is positioned as a financial support component of DANIDA's value chain support program covering tea, ginger, and dairy products.)

### 2.5.2 Bilateral Support

(1) Department for International Development: DFID

1) Center for Inclusive Growth

In response to the results of a joint survey conducted in 2008/09, with ADB and International Labour Organisation (ILO), which aimed to identify major impeding factors for Nepal's sustainable and broad-based economic development, DFID implements a program called the Center for Inclusive Growth to support sustainable and broad-based economic development. At present, it consists of a project to support macroeconomic development and a project to support policy formulation and implementation relating to the development of two sectors that are considered to have high growth potential in the country, namely electricity and tourism. As for the electricity sector, DFID assists the Nepal Investment Board in negotiating a large-scale hydropower generation project with the private sector by developing a contract and a tender process, providing training for necessary skills of stakeholders, and sending lawyers with international experience to help negotiation for an agreement with favorable terms and conditions. As for the tourism, DFID works together with local companies, entrepreneurs and investors in the Pokhara- Annapurna area for development of tourist resources.

2) Nepal Market Development Program (Samarth Nepal)

Nepal Market Development Program (Samarth Nepal) is designed to reduce poverty in villages and mountain areas by promoting agriculture and tourism. The program duration is between August 2011 and July 2016. In the agricultural sector, the program attempts to link farmers growing dairy products, vegetables, ginger, hatchery fish, and hogs to respective markets under the concept of "making markets work for the poor (M4P)." Also, it provides grants for Great Himalaya Trail Development Programme implemented by SNV. The programme aims to increase local employment and income by developing a cross-country Great Himalaya Trail with Trekking Agencies' Association of Nepal and thereby to attract treckkers to areas where they have not visited before.

3) Employment Fund Nepal

This program named Employment Fund Nepal is implemented by an international NGO, HELVETAS Swiss Intercooperation. DFID provides financial support, jointly with Swiss Agency for Development Corporation (SDC), for a three-month vocational training program for the youth in poverty and unable to go to school, especially women. Vocational training is conducted at community centers or factories where employment opportunity can be found, rather than conventional training facilities, and offers courses that are determined according to the actual needs of relevant industrial sectors. To this date, around 15,000 persons per year have completed the training and 80% have found a job or started their own business within a few months after completion.

While the program has produced significant results, whether to provide follow-up support after completion of the program is up in the air, because the World Bank and ADB are implementing or planning large-scale support for CTEVT.

4) Access to Finance

DFID plans to start a program focusing on the improvement of financial access in the far-western region by encouraging the establishment of branch offices by banks.

(2) US Agency for International Development: USAID

1) Nepal Economic, Agriculture and Trade (NEAT)

NEAT is a program implemented by USAID for the purpose of expanding better economic opportunities and ensuring food safety and security. The program is scheduled to continue until June 2013 and consists of the following four components: (1) improvement of the business environment through the reform of economic policy; (2) reinforcement of competitiveness of agricultural products; (3) food safety and security; and (4) expansion of access to microfinance service.

As for the improvement of the business environment, USAID works with 6-7 ministries (including MoF, MoCI, MoI, and MoA) toward amendment of acts relating to the private sector development (15-20 covering commerce, industry and agriculture) and regulatory changes. Also, USAID sends long-term consultants to the MoF for the purpose of helping the ministry to revise customs clearance procedures in line with the WTO guidelines and standards and providing training for capacity building of staff members of the ministries concerned. The program also includes assistance in the establishment of a Web site to publish investment information on Nepal (MoI as the counterpart and Confederation of Nepalese Industries as a partner).

As for the improvement of competitiveness of agricultural products, USAID provides advice and support covering lentil, ginger, orthodox tea, and off-season vegetables, including introduction of processing techniques (e.g., cleaning and selection) to comply with Good Agricultural Practice (GAP) and add value, and solution of problems seen in various steps of value chains, such as the absence of intermediate storage facilities (refrigerators) and complex customs clearance procedures.

Meanwhile, for the purpose of improving food safety and security, subsidy is given to 35,000 farms in three districts of the Mid-Western region, six districts of the Western region, and one district of the Far-Western region, for the purchase of seeds and fertilizers. Agricultural products eligible for the subsidy program are rice, wheat, maize, tomato, cauliflower, cabbage, and other vegetables, and farm animals (goats, hogs, and chicken). At the same time, the program extends to capacity building of government employees relating to agricultural support. Finally, USAID implements a separate program “Feed the Future Initiative (FFI)” to improve food safety and security.

As for expansion of access to microfinance service, USAID has conducted a feasibility study of the microfinance sector, including the mapping of microfinance service organizations, and is providing support for capacity building of such organizations and deployment of financial service in rural or remote areas where the establishment of a branch office is difficult, by using information technology.

2) Nepal Education for Income Generation Program

Nepal Education for Income Generation Program was carried out in 15 districts of the Mid-Western region for the five-year period between 2008 and 2012, for the purpose of increasing employment and income of the young age group. Originally, it had targeted victims of armed conflicts. Then it has extended to the youth in general and has provided support for around 74,000 persons.

The program features the provision of vocational training that meets the actual needs of the job market. In particular, it attempts to link trainees with job opportunities that had been identified prior to training. Also, it provides support for small farms to increase food security and income by promoting productivity improvement and establishing linkage with markets. Furthermore, the program covers education and training on basic knowledge required for business startup, life skills[20], nutrition and health, peace building, as well as provides scholarship for young people in poverty including Dalit.

(3) Deutsche Gesellschaft für Internationale Zusammenarbeit: GIZ

1) Inclusive Development of the Economy Programme (INCLUDE)

With an aim to create better employment opportunities and sources of income for the poor and the underprivileged, GIZ is implementing Inclusive Development of the Economy Programme (INCLUDE) that consists of the following three components: (1) enhancement of entrepreneur support service by the chamber of commerce and industry; (2) value chain development; and (3) capacity building for the private sector to encourage dialogue with the public sector. The program will end in December 2013, but it has been decided to extend its period for another three years.

[20] Abilities required to deal with problems and demands that arise in daily life in a constructive and effective manner

Under each component, a variety of activities are undertaken. Component (1) mainly supports the establishment of an One-stop Shop or a Startup Agency by the chambers of commerce and industry. Both of them provide all information required for business startup at a single place, including corporate registration procedures, including PAN number and VAT, business-related rules and regulations, and information on BDSs and financial institutions that can be used, while providing education and training before and after startup. Also, GIZ has revised and updated entrepreneurship development courses, jointly with CTEVT's Curriculum Division, to reflect actual business practice, and has trained 50 instructors.

In the area of value chain development, GIZ provides support for production increase, quality improvement and improvement of market access for honey, MAPs including and ginger, dairy products, vegetables and fruits grown in four districts (Kailali, Surhet, Dang, and Pyuyhan) [21] by improving service of local and district level associations[22]. Note that, as for 19 NTIS items, GIZ provides support for silver accessories in response to the request by the MoCs, in addition to honey and Maps for which program support has been provided prior to the formulation of NTIS.

Finally, to promote communication between the public and private sectors at the district level, GIZ provides support for the chambers of commerce and industry in connection with its efforts to identify issues local businesses face and to formulate reform proposals. As part of technical support, GIZ makes capacity building efforts to allow the chambers to conduct business environment surveys in an effective manner. It has also developed a training package of relationship skills to help generate constructive discussion and holds workshops. Finally, it provides support for the MoI in relation to the National Business Forum that provides a place for national-level dialogue between the government and the private sector.

2) Promotion of intra-regional trade potentials in the SAARC region

The program provides support for SAARC Trade Promotion Network (SAARC-TPN), which is organized by 28 public and private organizations in eight SAARC member nations to promote trade within the SAARC region, as well as five working groups in SAARC-TPN (non-tariff trade restriction, infrastructure, B-to-B initiative, trade information portal site, trade promotion for SMEs, and donor coordination), in the area of capacity building required to promote communication, improve organizational management, and identify problems that impede trade promotion. Note that the trade information portal site publishes all-inclusive information on SAARC member nations' trade policy and practice, including tariff rates, trade related procedures, and price ranges.

[21] Honey in Dang, Kailali and Surkhet, and MAPs including ginger in Pyuthan and Surkhet, and other products in Dang

[22] Training relating to cultivation techniques, provision of beehives, medical service and other materials and services, and installation of collection points

3) WTO/EIF Support Programme

GIZ, as a donor facilitator for Nepal within the WTO's Enhancement Integrated Framework, provides support in the following three areas by working jointly with the MoCS as counterpart: (1) efforts to identify non-tariff trade barriers and eliminate or reduce them; (2) effective utilization of project management and donor support in relation to the enforcement of NTIS; and (3) promotion of trade-related dialogue between the government and the private sector. As a NTIS pilot project, MAPs and silver accessories have been selected and action plans are formulated in cooperation of the private sector.

In addition, Physikalisch-Technische Bundesanstalt (PTB), the organization of legal metrology in Germany, provides technical support for Nepal Bureau of Standards & Metrology (NBSM) with regards to testing equipment and system. As GIZ provides support in relation to honey, MAPs, and silver accessories, it is planned to obtain certification on testing and analysis of these products.

Finally, KfW Banking Group – a German development bank – plans to conduct research and study on possibility of technical support in the area of microfinance.

(4) Swiss Agency for Development cooperation (SDC)

Local Chamber of Commerce and Industry boasts that Dolakha District is the home town of One District, One Product and heads behind none. Swiss Agency for Development Cooperation focuses on this department for the long time. Since 1975 until 1990, Integrated Hill Development Project was implemented by the agency. Since 1990, Technical Education and Vocational Training, Community Forest Project and Rural Health Development Project had been organized. Based on these long-term comprehensive approach, ODOP was implemented successfully in Dolakha District.

Table 2.5-1 shows an overall picture of donor organizations and their areas of activity in Nepal. Support programs are mainly seen in institutional and environmental improvement, financial access, vocational training, entrepreneurship development, and production and sales of agricultural products. Some programs are partially duplicated. On the other hand, direct support for production activity is concentrated on agricultural products, while the manufacturing sector is not a major target except for silver accessories. While institutional and environmental improvement is carried out mainly in cooperation of government agencies, which are inherently expected to play a leadership role, efforts are made to reflect opinions of the private sector by setting up a place for dialogue and to use the private sector, e.g., the investment information portal site established by CNI. Finally, direct support for farmers and entrepreneurs, such as the fostering of facilitators, is provided to cover an area that is not accessible to public support, in the form of joint efforts with the local chambers of commerce and trade associations. All in all, donor support programs are more and more inclined to an increasing involvement and role of the private sector.

## Table 2.5-1 Donnor Assistance Mapping

| | | F/P | Policy/ regulations | Private-Public Partnership | Investment | Trade | Access to finance | Training | Entrepreneurship development | Value chain | Assistance for specific sectors/products |
|---|---|---|---|---|---|---|---|---|---|---|---|
| WB/IFC | Project for Agriculture Commercialization and Trade (PACT) | | | | | ✔(Food standard, SPS) | | | | ✔ | |
| | Enhanced Vocational Education and Training | | ✔(TEVT) | | | | | ✔ | | | |
| | Nepal Investment Climate Reform Program | | ✔ | ✔ | ✔ | ✔ | | | | | |
| | Venture Capital | | | | | | ✔(Venture capital) | | | | |
| | Support for PPP infrastructure projects | | | | ✔ | | | | | | |
| | Various Supports for the financial sector development | | ✔(Financial sector) | | | | | | | | |
| ADB | Support for Formulating an Economic Development Vision | | ✔ | | | | | | | | |
| | Preparation of the Agricultural Development Strategy | | ✔(Agriculture) | | | | | | | | |
| | South Asia Subregional Economic Cooperation Trade Facilitation Program | | | | | ✔ | | | | | |
| | Skill Development Project | P | | | | | | ✔ | | | |
| UNDP | Micro-Enterprise Development Programme | | | | | | ✔(intermediation) | ✔Training of facilitators & BDS providers | ✔ | | |
| | Access to Financial Services | F | | | | | ✔Remote areas | | | | |
| UNCDF | Value Chain Finance | | | | | | ✔Actors in selected value chains | | | ✔ | Dairy, tea, ginger |
| | Access to Financial Services | F | | | | | ✔Remote areas | | | | |
| DFID | Center for Inclusive Growth | | ✔(Energy & Tourism) | | ✔ | | | | | | Energy, tourism |
| | Nepal Market Development Program (Samarth Nepal) | | | | | | | | | ✔ | Dairy, vegetables, ginger, aquaculture, pigs<br>Tourism (trekking) |
| | Employment Fund Nepal | | | | | | | ✔ | | | |
| | Access to Finance | P | | | | | ✔Remote areas | | | | |
| USAID | Nepal Education for Income Generation Program | F | | | | | | | ✔ | | |
| | Nepal Economic, Agriculture and Trade (NEAT) | | ✔ | | | | | | | ✔ | Tea, ginger, lentil, vegitables |
| GIZ | EIF | | | ✔ | | ✔ | | | | | |
| | Promotion of intra-regional trade potentials in the SAARC region | | | | | ✔ | | | | | |
| | Inclusive Development of the Economy Programme | | | ✔ | | | | | ✔ | ✔ | Honey, MAPs, dairy and vegetables & fruits |

F: complete、P: Planning stage
Source: Interviews with WB/IFC, ADB, UNDP, UNCDF, DFID, USAID, and GIZ

## 2.6 Major Issues relating to Industrial Policy

### 2.6.1 Issues relating to Industrial Policies and Programs

The Nepalese government appears to set forth well-developed, elaborate development policies including industry, which are incorporated into, among other things, medium- and long-term economic development plans and the Immediate Action Plan. Ministries also establish policies and programs on the basis of actual conditions facing their areas of responsibility, although they seemingly try to cover every policy agenda without setting priority. When it comes to actions that are to be taken to implement specific policies and programs, however, the government faces the following issues.

(1) Lack of political stability and leadership

The five-year economic development plans, the three-year development plans, and the emergency plan in 2012 are well prepared, accurately addressing the issues facing the country and setting forth the goals to be achieved. Major problems lie in poor consistencies between basic policies and strategies set forth in these plans and programs planned and executed by line ministries, lack of coordination among ministries or other relevant organizations, and lack of strong leadership which makes budgeting for implementing individual programs a political game. Furthermore, the lack of consistencies are also observed between the action plan and the basic policies due to the appropriate and opportune coordination.

(2) Delay in government budget execution

As the national assembly is adjourned[23], industrial development programs prepared by various ministries are held in suspension without deliberation for political authorization. In particular, the 2012/13 budget was compiled in two portions in July and December, which were then executed by the presidential decree. Furthermore, the approved budget basically follows the policy and substance of the previous one and does not include budgetary allocation for implementation of new programs. Naturally, no new programs formulated by ministries have been launched into action. The situation causes a significant delay in policy implementation, including industrial development.

(3) Continued accumulation of fiscal deficits due to overspending

The country's government finance is clearly in the state of persistent deficits caused by overspending. While annual fiscal deficits are made up by foreign aids, further deficits and capital account deficits generated by loan repayment are financed by loans from domestic sources. Overspending is the result of political instability, in which the preponderance of

[23] Constitutional Congress was dissolved in May, 2012. Thus, congress is dysfunctional until the general election is held.

political parties forces the government to accept their budgetary requests as a compromise to secure a parliamentary approval for the budget and related laws, thus sacrificing fiscal discipline.

(4) Shortages of staffs and budget at government organizations responsible for program implementation

In 2007, the Nepalese government introduced an early retirement system for employees for the purpose of reducing the overall workforce. As a result, most ministries and other government organizations responsible for program implementation fall short of their full strength. The same situation is seen at local government levels. For instance, the Department of Cottage & Small Industry (DoCSI) responsible for promotion of small enterprises, district offices of the Cottage & Small Industry Development Board (CSIDB), and the Trade & Export Promotion Center are suffering from a shortage of staff. At the same time, program implementation by government organizations is often subject to budgetary constraint that reflects fiscal deficits.

For instance, the annual budget for the programs in the Department of Industry is merely 3 million Rupees. This budget has to cover the activities of Investment Promotion, Investment Application Administration, Secretariat of Industrial Promotion Board in the department. To be honest, this limited budget may not be helpful for the proactive and significant activities of investment and trade promotion.

(5) Insufficient cooperation between ministries relating to industrial development and lack of commitment to promote industrial development

The Nepalese government appears to understand major problems and issues relating to promotion of the country's industrial development, but its industrial development policy lacks priority setting (concentration of efforts on selected areas) because of policy orientation toward socialistic egalitarianism. Furthermore, the government seems to lack a firm commitment to industrial development. Finally, there is an apparent lack of inter-ministerial cooperation in the area of industrial promotion, as typically seen in implementation of NTIS 2010 and programs by the Investment Board. Importance of industrial development seems to be emphasized mainly for political effect and is not fully reflected in the actual program implementation process.

As of Public and Private Partnership, it used to be difficult to promote since the public administration look down on the private sector. It, however, has been improving between two different sectors. For instance, Department of Industry organized the first Investment Promotion Seminar in 2012 with the support from FNCCI. Private sector provided know-how of seminar management and shared the stakeholder list with the government. Furthremore, Ministry of Industry leads the periodical public and private dialogue.

Nevertheless, still the gap between these sectors are significantly wide. Exchange of opinion is not well reflected in the real policies. Even Investment Board consists of the "Public" Department and "Private" Department. Their office, salary scale, academic background and professional qualification are totally different in these two departments.

(6) Industrial structure that is incapable of taking advantage of WTO membership

For Nepal that does not have a firm industrial base and infrastructure, its WTO membership that mandates economic liberalization and globalization creates a heavy pressure and burden. While the country still maintains a sizable negative item list of import, the hastened lowering of import tariff rates to the average of 12 %has resulted in the increase in local commodity tax rates and thus fails to bring benefits for people. At the same time, the country does not have many exportable products to take advantage of lowered tariff rates in other WTO member nations. In fact, the country's imports have grown substantially to a size six times as much as exports, partially preventing growth of industrial capital within the country while commercial capital dominates.

Economic Liberalization proceeds in the twised manner in Nepal. While the import of raw materials and consumer goods grow, the export declines. It is related with the lack of export-oriented products creation and the inconsistent duty policy influenced not by the industrial long-term objectives but by the political interests. Thus, duty policy in not coordinated with the other industrial policies.

On the other hand, regardless of the protective high duty and excise tax, consumption of imported cars and motorbikes grow tremendously. It is protagonized by the nepali consumers who receive the remittances. They have selective eyes due to the experiences abroad and increased income. In the future, the protective duty will not be the helpful political tool to promote the consumption of domestic products.

# Chapter 3 Outline and Analysis of Industrial Sector

# Chapter 3 Outline and Analysis of Industrial Sector

## 3.1 Agriculture

### 3.1.1 General Background

Table 3.1-1 presents key indicators relating to the agriculture sector in 1995/96 and 2009/10. The sector still occupies an important place in the Nepalese economy, accounting for around one third of the national economy as well as employining two thirds of working population, although the proportions are on a declining trend. After 1995/96, the agriculture sector has been growing at around 3% annually with a slight decline trend including ups and downs in between. Although it has improved moderately in the past 15 years in terms of economic scale and productivity, it is far from being a major driver for the national economy. Roughly speaking, rice accounts for around 20% of the sector's output, and three major crops including corn and wheat represent more than one third. Other crops account for 15%, livestock 25%, horticultural crops slightly less than 20%, and fishery 2%. The average land area per farm is 0.7 hectares and the majority is smaller than 0.5 hectares, suggesting that many farms only provide for themselves[1]. The Ministry of Agricultural Development is in charge of the development of the agricultural sector.

Table 3.1-1 Key Indicators in the Agricultural Sector in Nepal

| Indicator | 1995/96 | 2009/2010 |
|---|---|---|
| Agricultural GDP | $3.4 billion | $5.2 billion |
| Productivity of Agricultural Labor ($/person) | $466/person | $705/person |
| Agricultural Land per Household (ha/hh) | 1.1 | 0.7 |
| Percentage of holdings operating less than 0.5 ha | 40.1% | 51.6% |
| Productivity of Agricultural Land ($/ha) | $1,118/ha | $1,692/ha |
| Agricultural Land Use (cereal as percentage of cultivated land) | 80% | 80% |
| Seed turnover | 8% | 8% |
| Employment in Agriculture | 66% | 60% |
| Agricultural Exports | $32million | $248 million |
| Agricultural Imports | $157 million | $621 million |
| Poverty (2010 preliminary) | 42% | 25% |
| Percentage of households reporting inadequacy of food consumption | 50.9% | 15.7% |
| Stunting of Children (less than 5 years) | 60% | 42% |
| Irrigation cover (% of cultivated area) | 39.6% | 54% |
| Infrastructure (Rural Road Network km and Strategic Road Network km) | SRN = km 10,000 | RRN = 40,000 km<br>SRN = 20,000 km |
| ICT reach | Less than 10% connected | 46% connected |

Source: Agrifood Consulting International, Inc.. 2012. TA 7762-NEP Preparation of the Agricultural Development Strategy – Assessment Report.

[1] 30% of rice, around 40% of vegetables and potatoes are sold in the market, and the rest is consumed in-house. As a whole, 44.7% of agricultural yields are sold in the market.

### 3.1.1.1 Major Agricultural Products

(1) Cereals

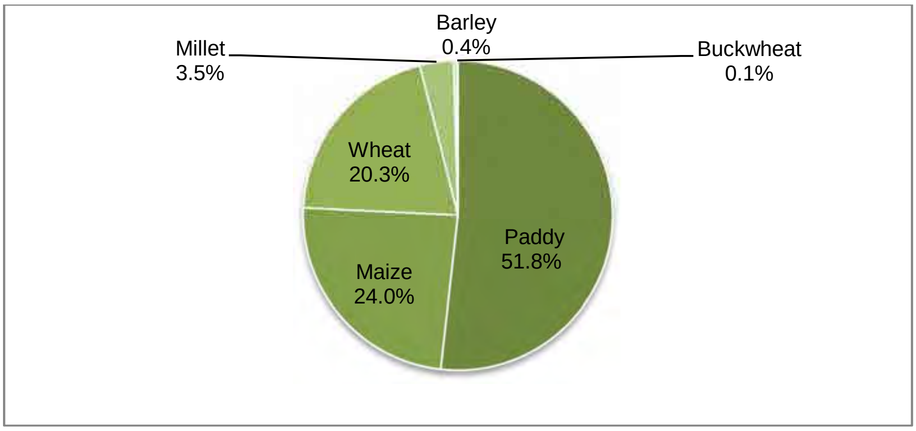
As shown in Table 3.1-1, 80% of cultivated land in Nepal produces cereals, including rice, maize, millet, buckwheat, wheat, and barley. Table 3.1-2 shows the changes in cultivation area and production for each crop. As seen from the table, between 1995/96 and 2010/11, production of wheat, maize and millet grew by 72%, 55%, and 7% respectively accompanied by increase in the cultivation areas. During the same period, paddy production increased by around 25%, while its cultivation area showed no substantial change. On the other hand, barley decreased by over 25% in terms of both cultivation area and production. The yield per hectare increased during the period for all crops (no data available for buckwheat) but barley which showed little change. In particular, yields of wheat, maize and rice increased by 47%, 36%, and 25% respectively. Figure 3.1-1 shows the breakdown of cereal production.

Table 3.1-2 Area and Production of Cereal Crops

(Area: Hectare, Production: 1,000 ton)

| | Paddy | | Maize | | Millet | | Buckwheat | | Wheat | | Barley | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Area | Prod. | Area | Prod. | Area | Prod. | Area | Prod. | Area | Prod. | Area | Prod. |
| 1995/96 | 1,496.8 | 3,578.8 | 791.7 | 1,331.1 | 260.1 | 282.4 | N/A | N/A | 653.5 | 1,012.9 | 39.4 | 41.3 |
| 2000/01 | 1,560.0 | 4,216.5 | 824.5 | 1,484.1 | 259.9 | 282.9 | N/A | N/A | 641.0 | 1,157.9 | 28.2 | 30.5 |
| 2005/06 | 1,549.4 | 4,209.3 | 850.9 | 1,734.4 | 261.7 | 290.9 | N/A | N/A | 672.0 | 1,394.1 | 26.2 | 27.8 |
| 2006/07 | 1,439.5 | 3,680.8 | 870.4 | 1,819.9 | 265.2 | 284.8 | N/A | N/A | 702.7 | 1,515.1 | 26.6 | 28.3 |
| 2007/08 | 1,549.3 | 4,299.2 | 870.2 | 1,878.6 | 265.5 | 291.1 | N/A | N/A | 706.5 | 1,572.1 | 26.1 | 28.1 |
| 2008/09 | 1,555.9 | 4,523.7 | 875.4 | 1,930.7 | 265.9 | 292.7 | N/A | N/A | 695.0 | 1,343.9 | 25.8 | 23.2 |
| 2009/10 | 1,481.3 | 4,023.8 | 875.7 | 1,855.2 | 268.5 | 299.5 | N/A | N/A | 731.1 | 1,556.5 | 26.6 | 27.6 |
| 2010/11 | 1,496.5 | 4,460.3 | 906.3 | 2,067.5 | 269.8 | 302.7 | 10.3 | 8.8 | 767.5 | 1,745.8 | 28.5 | 30.2 |

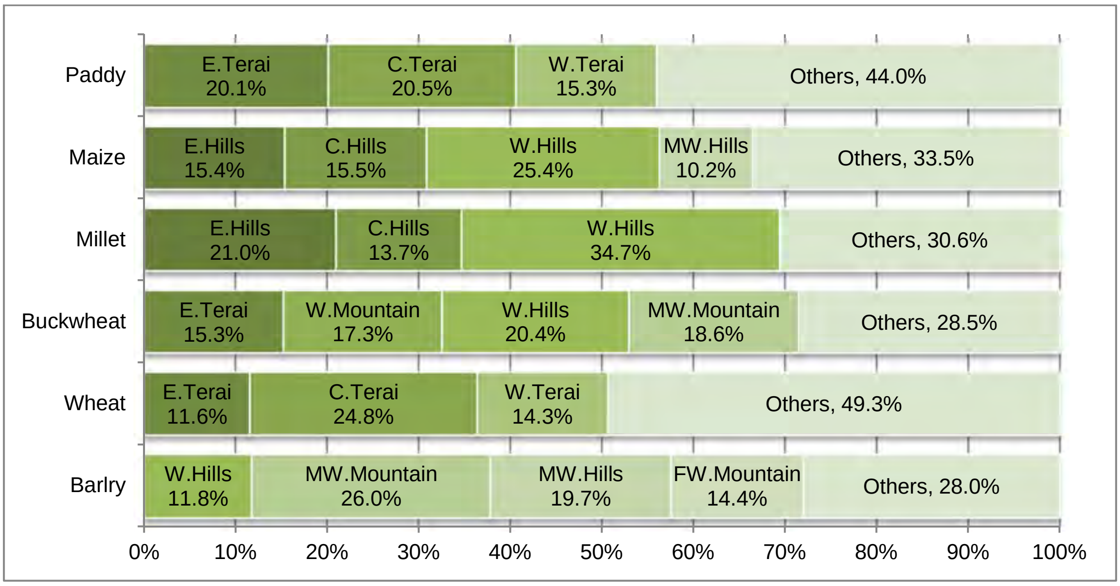
Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068).




Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

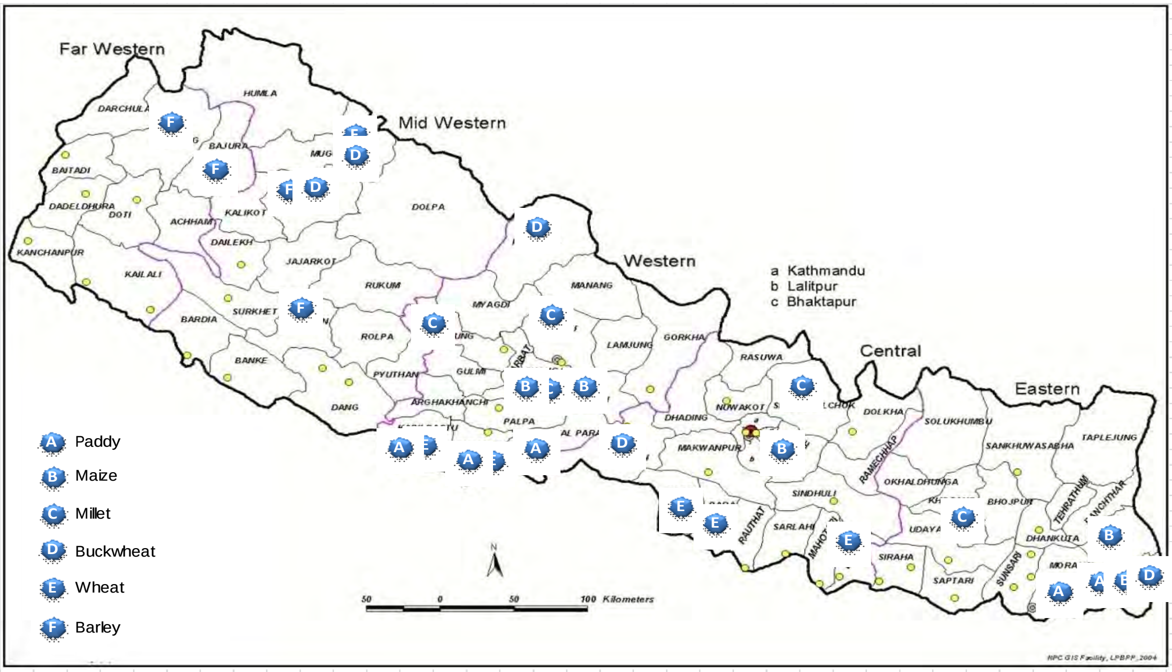
Figure 3.1-1 Breakdown of the Cereal Production (2010/11)

As shown in Figure 3.1-2, paddy and wheat are mainly produced in the East, Central and West Terai regions, whereas maize and millet are chiefly grown in the East, Central and West hill areas. Barley production comes from the Midwest mountain, West mountain and hills, and the East Terai. Finally, the West hills, Mid-West mountain and hills, and Far-West mountain regions collectively produce over 70% of barely. Figure 3.1-3 shows top five districts in production of the cereals.




Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

Figure 3.1-2 Cereal Production by Region (2010/11)




Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

Figure 3.1-3 Top Five Districts in Cereal Production (2010/11)

(2) Major Cash Crops (Oil seed, Potato, Tobacco, Sugarcane and Jute)

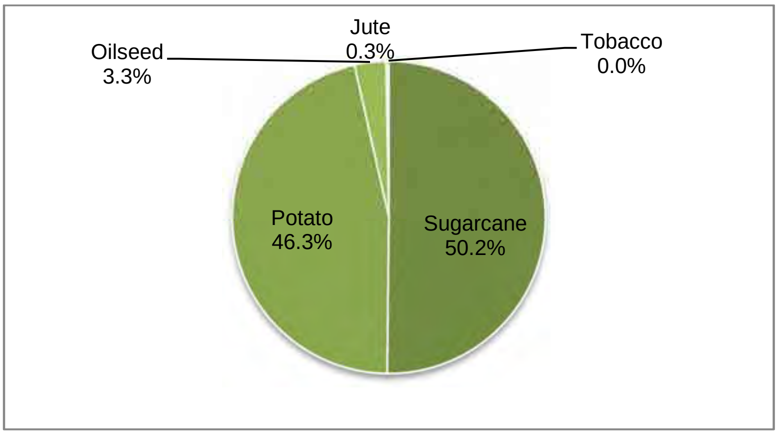
The government of Nepal indentifies oil seeds, potatoes, tobaccos, sugarcanes and jutes as major cash crops (Table 3.1-3). Oil seeds, potatoes and sugarcanes increased over the 1995/96 - 2010/11 period in terms of both cultivation area and production, and the yield per hectare in 2010/11 rose by 31%, 62%, and 23% respectively, over 1995/96. On the other hand, tobacco is in a long-term declining trend in both cultivation area and production. Jute is recently in a declining trend although it once increased. Figure 3.1-4 shows the weight-based breakdown of major cash crops production. Oil seeds and potatoes are widely grown, but the major production area of the former is the entire Terai whereas those of potates are the East region and the Central hills and Terai (Figure 3.1-5). Sugarcanes (57.1%) and tobaccos (80.5%) are produced in the Central Terai area.

Table 3.1-3 Area and Production of Major Cash Crops

(Area: Hectare, Production: 1,000 Ton)

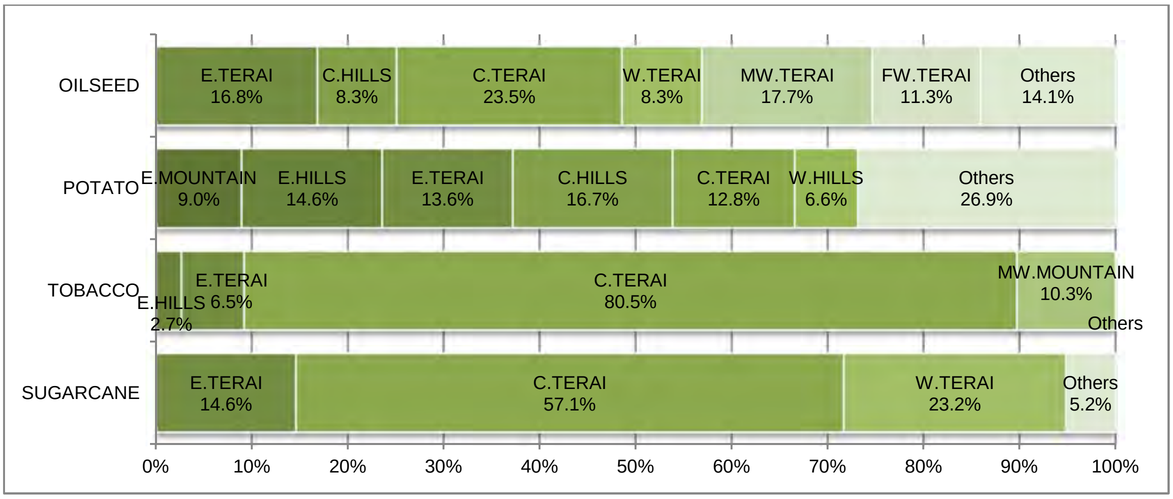
| | Oilseed | | Potato | | Tobacco | | Sugarcane | | Jute | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Area | Prod. | Area | Prod. | Area | Prod. | Area | Prod. | Area | Prod. |
| 1995/96 | 185.0 | 116.0 | 106.0 | 898.4 | 6.1 | 5.5 | 44.8 | 1568.7 | 11.2 | 15.0 |
| 2000/01 | 188.5 | 132.3 | 129.0 | 1313.7 | 4.2 | 4.0 | 59.4 | 2211.8 | 11.3 | 16.4 |
| 2005/06 | 188.1 | 139.3 | 150.9 | 1974.8 | 2.7 | 2.7 | 62.1 | 2462.6 | 12.0 | 17.1 |
| 2006/07 | 184.2 | 135.7 | 153.5 | 1943.2 | 2.7 | 2.6 | 64.0 | 2599.8 | 11.7 | 16.8 |
| 2007/08 | 180.3 | 134.3 | 156.7 | 2054.8 | 2.7 | 2.6 | 63.0 | 2485.4 | 11.6 | 17.0 |
| 2008/09 | 181.4 | 135.5 | 181.9 | 2424.0 | 2.5 | 2.5 | 58.1 | 2354.4 | 11.7 | 17.7 |
| 2009/10 | 198.5 | 155.1 | 185.3 | 2517.7 | 2.5 | 2.5 | 58.3 | 2495.1 | 10.5 | 13.0 |
| 2010/11 | 213.7 | 176.2 | 182.6 | 2508.0 | 1.1 | 1.2 | 63.0 | 2718.2 | 10.6 | 14.4 |

Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)




Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

Figure 3.1-4 Breakdown of Major Cash Crops Production (2010/11)




出所: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

Figure 3.1-5 Cash Crops Production by Region (2010/11)

Figure 3.1-6 shows top five districts in production of the cash crops.


Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

Figure 3.1-6 Top Five Districts in Cash Crops Production (2010/11)

(3) Pulses

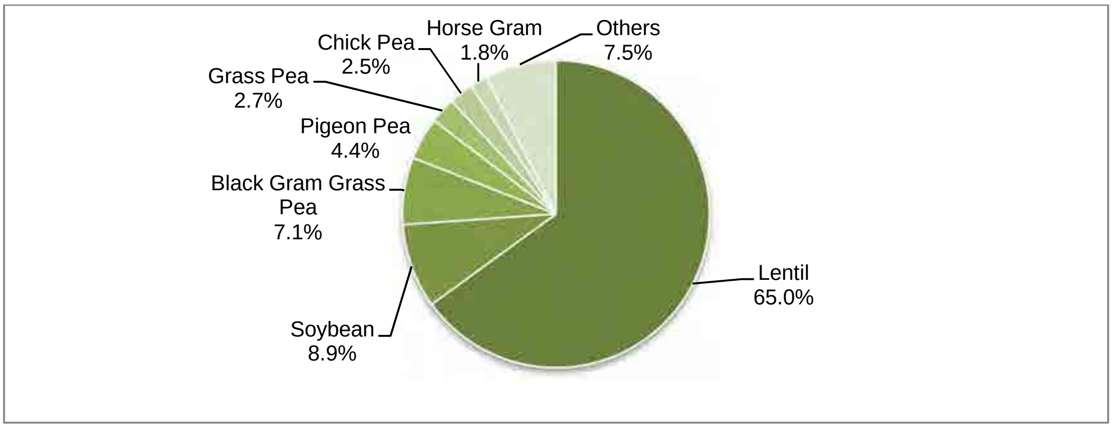
As shown in Table 3.1-4 and Figure 3.1-7, lentil production of 207 thousand ton in 2010/11 is by far the largest among pulses, followed by soybean (28 thousand ton) and black gram (23 thousand ton). During the period between 2000/01 and 2010/11, lentil and soybean production grew with the increase in cultivation area and yield per hectare (45% and 62% respectively in yield), whereas chickpea and pigeon pea production declined with the decrease in cultivation area. The yield for pigeon pea has lowered. Lentil is mainly grown in the Terai, the Central and Mid-West Terai in particular; soybean in the hills, especially the Central hills; and black gram in the East and West hills areas (Figure 3.1-8).

Table 3.1-4 Area and Production of Pulses

(Area: Hectare, Production: 1,000 Ton)

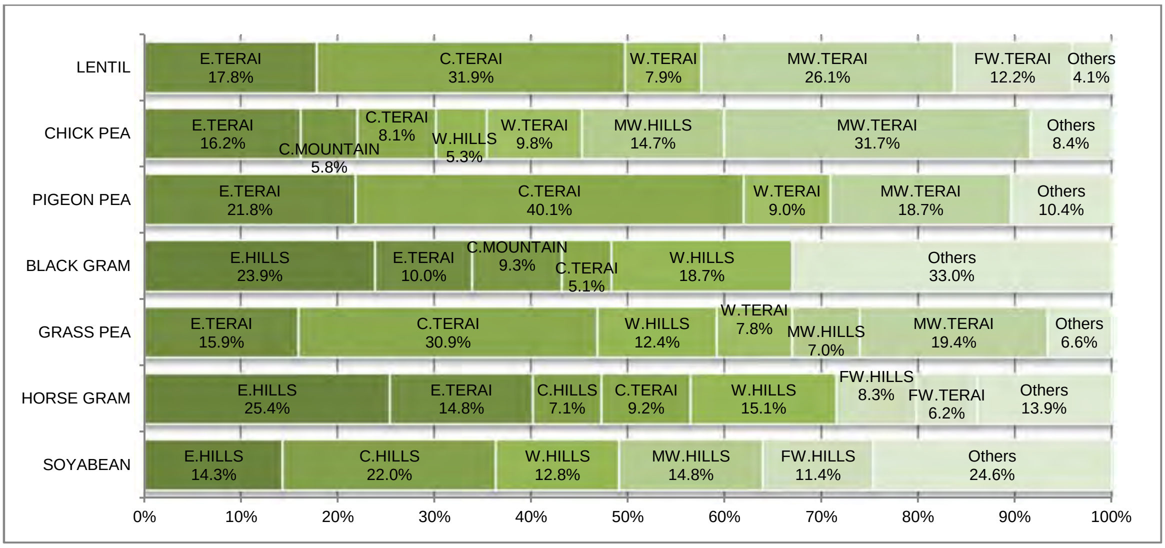
| | Lentil | | Chick Pea | | Pigeon Pea | | Black Gram | |
|---|---|---|---|---|---|---|---|---|
| | Area | Prodn | Area | Prodn | Area | Prodn | Area | Prodn |
| 2000/01 | 178.7 | 143.1 | 14.6 | 12.1 | 24.0 | 20.9 | 30.3 | 21.6 |
| 2005/06 | 183.2 | 158.0 | 10.2 | 8.4 | 20.7 | 19.1 | 32.8 | 25.5 |
| 2006/07 | 189.2 | 164.7 | 10 | 8.1 | 21 | 19.2 | 32.8 | 25.4 |
| 2007/08 | 189.5 | 161.1 | 9.2 | 7.3 | 21.4 | 18.8 | 32.9 | 25.7 |
| 2008/09 | 183.8 | 147.7 | 8.5 | 6.9 | 20.9 | 18.2 | 33.1 | 26.0 |
| 2009/10 | 187.4 | 151.8 | 8.6 | 7.1 | 21.3 | 18.6 | 33.8 | 26.7 |
| 2010/11 | 207.6 | 206.9 | 9.1 | 8.1 | 17.5 | 14.1 | 27.5 | 22.5 |
| | Grass Pea | | Horse Gram | | Soybean | | Others | |
| | Area | Prodn | Area | Prodn | Area | Prodn | Area | Prod |
| 2000/01 | 8.7 | 6.8 | 8.4 | 5.2 | 20.7 | 17.5 | 20.7 | 16 |
| 2005/06 | 6.3 | 4.8 | 8.0 | 5.8 | 23.1 | 20.6 | 29.2 | 25.3 |
| 2006/07 | 6.2 | 4.7 | 8 | 5.9 | 23.2 | 21.0 | 29.3 | 25.4 |
| 2007/08 | 6.6 | 4.9 | 7.8 | 5.4 | 23.2 | 21.0 | 29.8 | 25.5 |
| 2008/09 | 5.9 | 4.3 | 7.8 | 5.4 | 23.5 | 21.5 | 29.8 | 25.5 |
| 2009/10 | 6.0 | 4.5 | 8.0 | 5.5 | 23.9 | 22.0 | 30.4 | 26.2 |
| 2010/11 | 9.2 | 8.7 | 7.9 | 5.8 | 29.3 | 28.3 | 26.2 | 23.9 |

Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)




Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

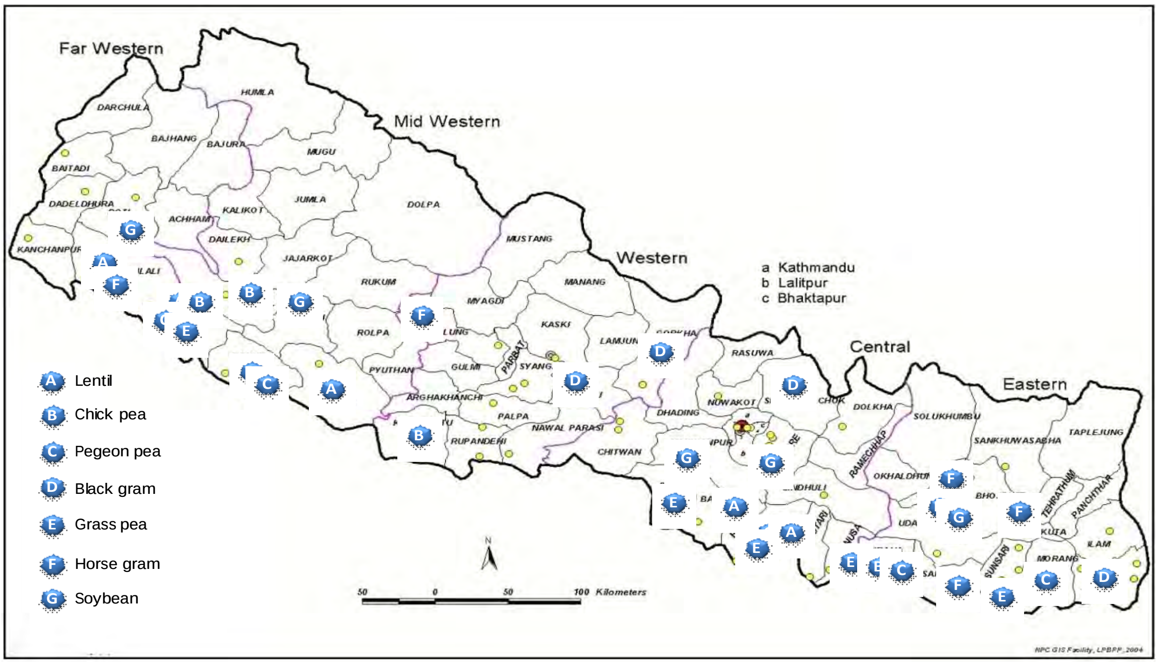
Figure 3.1-7 Breakdown of Pulses Production (2010/11)




Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information on Nepalese Agriculture 2010/2011 (2067/068)

Figure 3.1-8 Pulses Production by Region (2010/11)

Figure 3.1-9 shows top five districts in production of pulses.

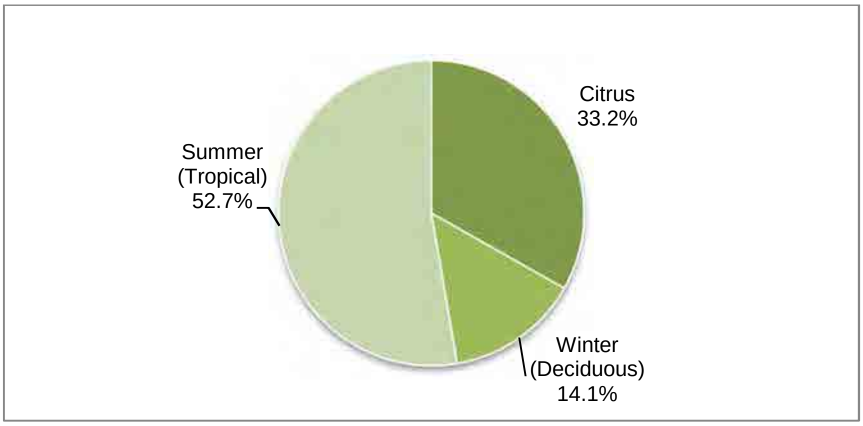



Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information on Nepalese Agriculture 2010/2011 (2067/068)

Figure 3.1-9 Top Five Districts in Pulses Production (2010/11)

(4) Fruits

As for fruits, tropical fruits boast the largest production (Figure 3.1-10), while production of citrus fruits, which are grown mainly in the Central and West hill areas, show the highest growth rate of 117% over the period between 2000/01 and 2010/11 (Table 3.1-5). Their cultivation area and yield also increased by 99% and 9% respectively On the other hand, yields of deciduous and tropical fruits lowered slightly although cultivation areas expanded and production increased. As a single item, mandarin production is the largest at 179,494 tons (Figure 3.1-11).




Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

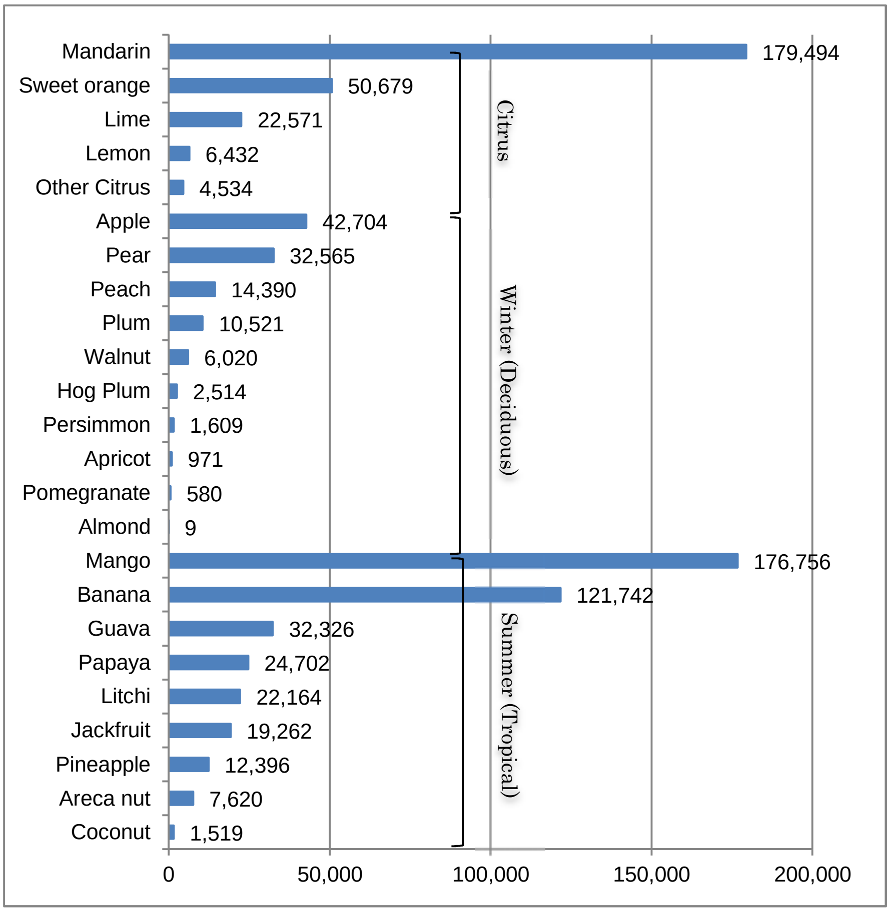
Figure 3.1-10 Breakdown of Fruits Production (2010/11) -1

Table 3.1-5 Area and Production of Fruits

(Area: Hectare, Production: Metric Ton)

| Year | Citrus | | Winter (Deciduous) | | Summer (Tropical) | | Total | |
|---|---|---|---|---|---|---|---|---|
| | Area | Production | Area | Production | Area | Production | Area | Production |
| 2000/01 | 20.7 | 121.7 | 15.7 | 89.5 | 37.4 | 276.2 | 73.8 | 487.3 |
| 2005/06 | 26.7 | 164.1 | 19.3 | 96.2 | 45.9 | 275.1 | 91.9 | 535.4 |
| 2006/07 | 28.0 | 171.9 | 19.9 | 97.7 | 47 | 305.5 | 94.9 | 575.1 |
| 2007/08 | 30.8 | 226.4 | 20.4 | 99.8 | 48.9 | 304.4 | 100.1 | 630.6 |
| 2008/09 | 32.3 | 253.8 | 21.6 | 103.1 | 49.7 | 329.3 | 103.7 | 686.2 |
| 2009/10 | 33.9 | 259.2 | 22.5 | 107.6 | 50.9 | 340.2 | 107.3 | 707 |
| 2010/11 | 35.6 | 263.7 | 24.1 | 111.9 | 58.3 | 418.6 | 117.9 | 794.2 |

Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)




Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

Figure 3.1-11 Breakdown of Fruits Production (tons) (2010/11) -2

Figure 3.1-12 to 3.1-14 shows top five districts in production of major citrus, deciduous, and tropical fruits. As already described, citrus are grown in the hills. As for deciduous fruits, apples, pears, peaches and plums are produced a lot. Apples are mostly grown in the Midwest mountain areas, while pears, peaches and plums are widely cultivated in hills and mountains, especially those in the East to West regions. Tropical fruits are mainly mangos and bananas, both of which are primarily grown in the East, Central and West regions.


Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

Figure 3.1-12 Top Five Districts in Citrus Fruits Production (2010/11)


Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

Figure 3.1-13 Top Five Districts in Deciduous Fruits Production (2010/11)


Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

Figure 3.1-14 Top Five Districts in Tropical Fruits Production (2010/11)

(5) Vegetable

Vegetable production has been steadily growing with an increase in cultivation area, too. Between 1995/96 and 2010/11, the cultivation area, production, and yield increased by 69%, 141%, and 43% respectively (Table 3.1-6).

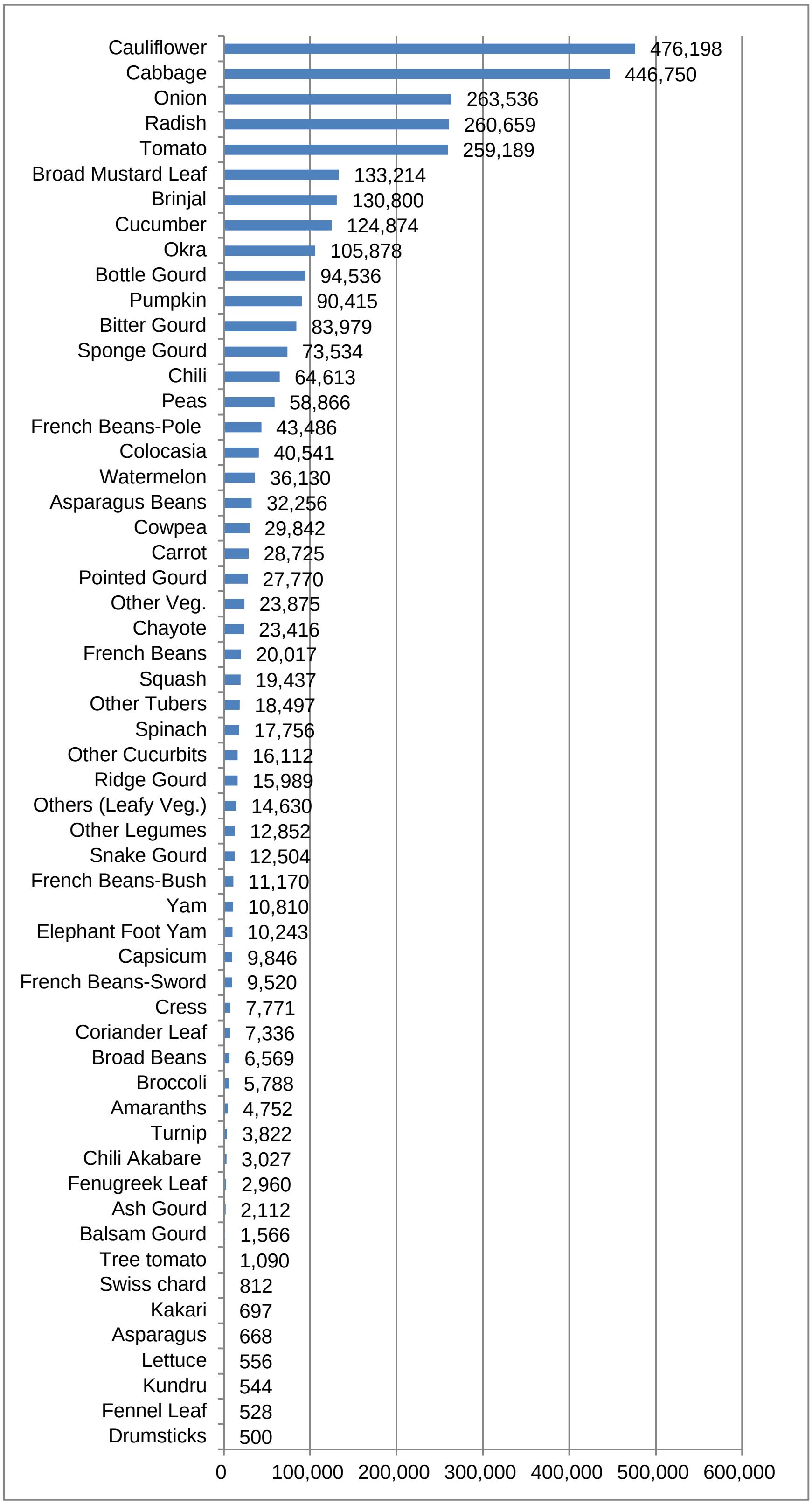
Table 3.1-6 Area and Production of Vegetables

(Area: Hectare, Production: Metric tons, Yield: Metric tons/ha)

| | Area | Prod. | Yield |
|---|---|---|---|
| 1995/96 | 144,368 | 1,327,298 | 9,194 |
| 2000/01 | 157,162 | 1,652,979 | 10,518 |
| 2001/02 | 161,048 | 1,738,086 | 10,792 |
| 2005/06 | 189,832 | 2,190,100 | 11,537 |
| 2006/07 | 191,922 | 2,298,689 | 11,977 |
| 2007/08 | 208,108 | 2,538,904 | 12,200 |
| 2008/09 | 225,154 | 2,754,406 | 12,233 |
| 2009/10 | 235,098 | 3,003,821 | 12,777 |
| 2010/11 | 244,102 | 3,203,563 | 13,124 |

Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information on Nepalese Agriculture 2010/2011 (2067/068)

On a weight basis, cauliflowers are produced most, followed by cabbages, onions, radish, and tomatoes (Figure 3.1-15). As shown in Figure 3.1-16, these vegetables are mainly produced in the East to Central hills and the East to Midwest Terai.




Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

Figure 3.1-15 Vegetables Production (tons) (2010/11)


Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

Figure 3.1-16 Top Five Districts in Major Vegetables Production (2010/11)

(6) Spices

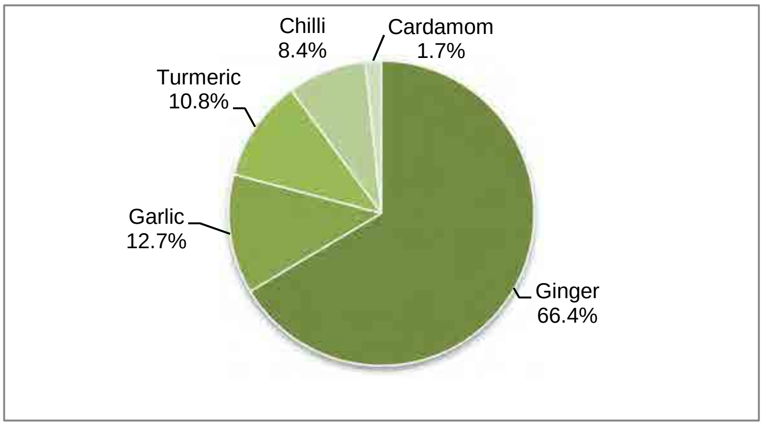
Nepal produces cardamom, ginger, garlic, turmeric, and hot pepper. As shown in Table 3.1-7 and Figure 3.1-17, production of ginger is by far the largest at 216 thousand ton. Figure 3.1-18 shows spices production by region. Cardamom is mostly cultivated in the East mountain and hill areas, while ginger is largely produced in the East to Midwest hills, garlic in the Central hills and Terai.

Table 3.1-7 Area and Production of Spices (2010/11)

(Area: Hectare, Production: Metric Ton)

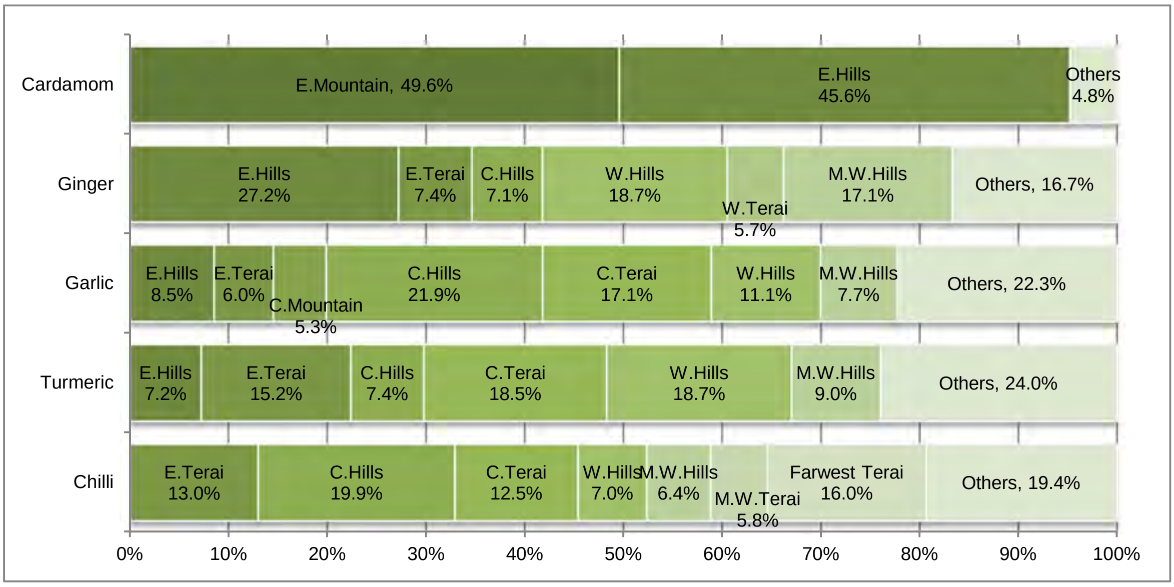
| Cardamom | | Ginger | | Garlic | | Turmeric | | Chili | |
|---|---|---|---|---|---|---|---|---|---|
| Total Area | Prodn. | Area | Prodn. | Area | Prodn. | Area | Prodn. | Area | Prodn. |
| 14,787 | 5,517 | 19,081 | 216,289 | 5,773 | 41,290 | 4,080 | 35,295 | 6,349 | 27,203 |

Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information on Nepalese Agriculture 2010/2011 (2067/068)




Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

Figure 3.1-17 Breakdown of Spices Production (2010/11)




Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

Figure 3.1-18 Spices Production by Region (2010/11)

Figure 3.1-19 shows top five districts in spices production.


Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information on Nepalese Agriculture 2010/2011 (2067/068)

Figure 3.1-19 Top Five Districts in Spices Production (2010/11)

(7) Tea and Coffee

As shown in Table 3.1-8, 1,7437 tons of tea were cultivated from 17,451 hectares in 2010/11. Tea is grown mostly in the East hills and Terai (Table 3.1-9). Small-scale farmers as well as plantations are engaged in tea leaves production. Nearly 90% of them are for CTC (Crush tear Curl) while the rest are for orthodox tea (Table 3.1-10). Tea leaves for the former are grown in Terai, and those for the latter are in hills, which is consistent with the fact that Jhapa produces nealy 90% of them. Note that the cultivation areas are not that different between them; 8,272 hectares are for orthodox tea leaves whereas 9,179 are for CTC leaves.

Table 3.1-8 Area and Production of Tea

(Area: Hectare, Production: Metric Ton)

| | Plantation area | | | | Production | | | |
|---|---|---|---|---|---|---|---|---|
| | Private | NTDC | Small holder | Total | Private | NTDC | Small holder | Total |
| 1992/93 | | | | | 754.0 | 860.0 | 0 | 1,614.0 |
| 1993/94 | | | 493 | | 687.0 | 982.0 | 75.0 | 1,744.0 |
| 1994/95 | | | 644 | | 837.0 | 1,009.4 | 100.0 | 1,946.4 |
| 1995/96 | | | 828 | | 1,500.0 | 1,112.3 | 125.0 | 2,737.3 |
| 1996/97 | 1,685 | 938 | 879 | 3,502 | 1,800.0 | 925.9 | 180.0 | 2,905.9 |
| 1997/98 | 2,192 | 938 | 1,385 | 4,515 | 1,946.5 | 603.1 | 469.0 | 3,018.6 |
| 1998/99 | 6,073 | 938 | 3,239 | 10,250 | 3,577.9 | 496.9 | 418.2 | 4,493.0 |
| 1999/00 | 6,073 | 938 | 3,239 | 10,250 | 3,577.9 | 496.9 | 1,010.5 | 5,085.2 |
| 2000/01 | 8,179 | | 3,818 | 11,997 | 5,089.6 | 0 | 1,549.5 | 6,639.1 |
| 2001/02 | 8,179 | | 4,186 | 12,365 | 5,864.7 | 0 | 1,653.9 | 7,518.6 |
| 2002/03 | 8,321 | | 4,314 | 12,635 | 6,478.0 | 0 | 1,720.0 | 8,198.0 |
| 2003/04 | 8,869 | | 6,143 | 15,012 | 7,714.7 | 0 | 3,956.5 | 11,671.2 |
| 2004/05 | 8,312 | | 6,989 | 15,301 | 7,789.9 | 0 | 4,816.2 | 12,606.1 |

| | Plantation area | | | | Production | | | |
|---|---|---|---|---|---|---|---|---|
| | Private | NTDC | Small holder | Total | Private | NTDC | Small holder | Total |
| 2005/06 | 8,911 | | 7,100 | 16,011 | 8,443.9 | 0 | 5,244.3 | 13,688.2 |
| 2006/07 | 9,011 | | 7,409 | 16,420 | 9,340.7 | 0 | 5,827.0 | 15,167.6 |
| 2007/08 | 9,030 | | 7,564 | 16,594 | 9,940.3 | 0 | 6,187.2 | 16,127.5 |
| 2008/09 | 9,063 | | 7,655 | 16,718 | 9,990.0 | 0 | 6,218.1 | 16,208.1 |
| 2009/10 | 9,159 | | 7,968 | 17,127 | 10,237.5 | 0 | 6,370.0 | 16,607.6 |
| 2010/11 | 9,331 | | 8,120 | 17,451 | 10,749.4 | 0 | 6,688.5 | 17,437.9 |

Source：National Tea and Coffee Development Board. 2012. Tea-Coffee.

### Table 3.1-9 Area and Production of Tea (2010/2011）

(Area: Hectare, Production: Metric Ton)

| | Total | |
|---|---|---|
| | Area | Production |
| Jhapa | 9,179 | 15,195.2 |
| Ilam | 5,417 | 1,718.7 |
| Panchathar | 897 | 242.5 |
| Dhankuta | 467 | 133.1 |
| Terathum | 268 | 50.0 |
| Others | 1,223 | 98.4 |
| Total | 17,451 | 17,437.9 |

Source：National Tea and Coffee Development Board. 2012. Tea-Coffee.

### Table 3.1-10 Composition of Tea Leaves (2010/11)

(Area: Hectare, Production: Metric Ton)

| | Orthodox | | CTC | | Total | |
|---|---|---|---|---|---|---|
| | Area | Production | Area | Production | Area | Production |
| Garden | 3,133 | 745.8 | 6,198 | 10,003.6 | 9,331 | 10,749.4 |
| Small farmers | 5,139 | 1,496.9 | 2,981 | 5,191.6 | 8,120 | 6,688.5 |
| Total | 8,272 | 2,242.7 | 9,179 | 15,195.2 | 17,451 | 17,437.9 |

Source：National Tea and Coffee Development Board. 2012. Tea-Coffee.

Whereas coffee cultivation area was 135.7 hectares in 1994/95, it increases by 13 times to 1,752 hectares in 2010/11. As shown in Table 3.1-11, parchment bean produced in 2010/11 is 502 tons. According to Agricultural Enterprise Center (AEC), 35 to 38 kg of dry beans, 23 to 24 of parchment beans, or 16.5 to 18.5 kg of green beans are produced from 100 kg of ripe cherries.[2] Table 3.1-11 shows estimated amount produced each year assuming the proportion of ripe cherries, dry beans, parchment beans, and green bean as 100:35.5:23.5:17.5. The estimates are not very far from actural figures, given that the production of green beans in 2011/12 is 418 according to Nepal Coffee Producers Association (NCPA).

[2] AEC. The Study Report on Trade Competitiveness of Nepalese Coffee. 2006.

### Table 3.1-11 Area and Production of Coffee

(Area: Hectare, Production: Metric Ton)

| | Area | Production (dry cherry) | Production (parchment bean) | <Estimate> Production (green bean) |
|---|---|---|---|---|
| 1994/95 | 135.7 | 12.95 | | *6.4* |
| 1995/96 | 220.3 | 29.2 | | *14.4* |
| 1996/97 | 259 | 37.35 | | *18.4* |
| 1997/98 | 272.1 | 55.9 | | *27.6* |
| 1998/99 | 277.1 | 44.5 | | *21.9* |
| 1999/00 | 314.3 | 72.4 | | *35.7* |
| 2000/01 | 424 | 88.7 | | *43.7* |
| 2001/02 | 596 | 139.2 | | *68.6* |
| 2002/03 | 764 | 139.2 | | *68.6* |
| 2003/04 | 952.2 | 217.6 | | *107.3* |
| 2004/05 | 1,078 | 250 | | *123.2* |
| 2005/06 | 1,285 | 391 | | *192.7* |
| 2006/07 | 1,295.5 | | 270 | *201.1* |
| 2007/08 | 1,145 | | 265 | *197.3* |
| 2008/09 | 1,531 | | 334 | *248.7* |
| 2009/10 | 1,630 | | 429 | *319.5* |
| 2010/11 | 1,752 | | 502 | *373.8* |

Source: National Tea and Coffee Development Board. 2012. Tea-Coffee.

Table 3.1-12 shows coffee production by district. According to NCPA, 22 districts currently produce coffee beans.

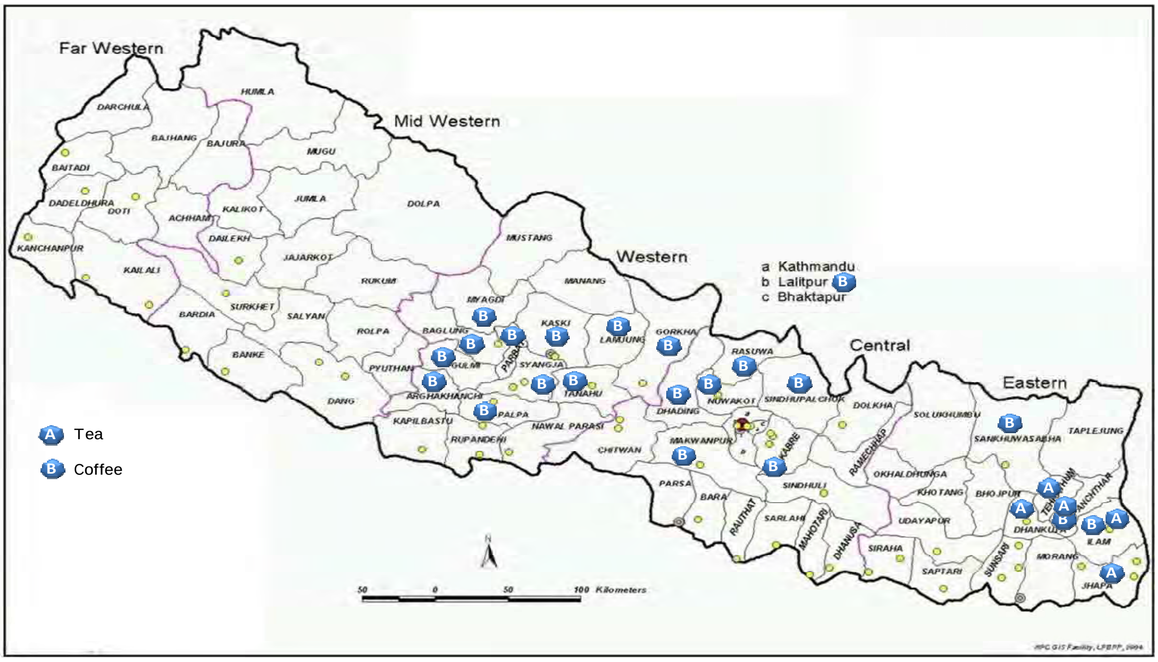
### Table 3.1-12 Area and Production of Parchment Coffee (2010/2011)*

(Area: Hectare, Production: Metric Ton)

| District | Area | Production |
|---|---|---|
| Syangja | 230 | 48.4 |
| Lalitpur | 115 | 47.8 |
| Gulmi | 112 | 45.2 |
| Kavrepalanchok | 130 | 35 |
| Nuwakot | 79 | 30.5 |
| Kaski | 95 | 24.6 |
| Arghakhachi | 76 | 23.5 |
| Palpa | 188 | 22.7 |
| Sindhupalchok | 87 | 17.3 |
| Lamjung | 149 | 15 |
| Ilam | 45 | 15 |
| Banlunga | 42 | 14.7 |
| Parbat | 45 | 9.5 |
| Panchthar | 33 | 7 |
| Dhading | 35 | 6.5 |
| Gorkha | 95 | 5.5 |
| Tanahu | 52 | 4 |
| Makwanpur | 25 | 4 |
| Sakhuwashava | 18 | 3 |
| Mayagdi | 12 | 2 |
| Rasuwa | 32 | 1 |
| Others | 47 | 19.3 |
| Total | 1742 | 401.5 |

*Total amount is not same as that in Table 3.1-13.
Source: National Tea and Coffee Development Board. 2012. Tea-Coffee.

Figure 3.1-20 shows districts listed in Table 3.1-9 and 3.1-12. Although the Central to West hills are the major coffee production area, but mountains in these two regions as well as the East hills also grow coffee. Note that, according to National Tea and Coffee Development Board, tea production has expanded beyond the East region.




Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information on Nepalese Agriculture 2010/2011 (2067/068)

Figure 3.1-20 Major Tea and Coffee Production Area(2010/11)

(8) Cocoons, Honey, Flowers and Mushrooms

As shown in Table 3.1-13, production of mulberries and cocoons is recently on the decline. Cocoon production in 2010/11 amounted to 26.1 tons.

Table 3.1-13 Area of Mulberry and Cocoon Production

(Area: Hectare, Production: Metric Ton)

| | Area | Production |
|---|---|---|
| 1996/97 | 217 | 24.5 |
| 1997/98 | 105 | 18.0 |
| 1998/99 | 225 | 20.3 |
| 1999/00 | 214 | 25.7 |
| 2000/01 | 245 | 31.4 |
| 2001/02 | NA | 35.2 |
| 2004/05 | NA | 35.0 |
| 2005/06 | NA | 33.0 |
| 2006/07 | NA | 31.3 |
| 2007/08 | NA | 33.0 |
| 2008/09 | NA | 23.3 |
| 2009/10 | 1300 | 26.4 |
| 2010/11 | 1380 | 26.1 |

Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information on Nepalese Agriculture 2010/2011 (2067/068)

On the other hand, honey production reached 1,365 tons in 2010/11, more than doubled the 2005/06 production of 650 tons (Table 3.1-14).

Table 3.1-14 Bee Keeping and Honey Production

(Production: Metric Ton)

| | Number of Bee Hives | Production |
|---|---|---|
| 1996/97 | 588 | 60 |
| 1997/98 | 800 | 100 |
| 1998/99 | 1,000 | 129 |
| 1999/00 | 1,050 | 150 |
| 2000/01 | 1,100 | 155 |
| 2001/02 | 126,884 | 529 |
| 2002/03 | 127,501 | 530 |
| 2003/04 | 130,000 | 577 |
| 2004/05 | 130,000 | 600 |
| 2005/06 | 125,100 | 650 |
| 2006/07 | 124,500 | 650 |
| 2007/08 | 124,500 | 1,000 |
| 2008/09 | 124,500 | 650 |
| 2009/10 | 140,000 | 1,100 |
| 2010/11 | 140,850 | 1,365 |

Note: after 2001/02, the figures include the number of natural bee hives and its production.
Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information on Nepalese Agriculture 2010/2011 (2067/068)

Notably, mushroom production is recently growing, reaching 1,530 tons in 2010/11 (Table 3.1-15). Also, production of plants and flowers is said to expand recently, responding to the growing demand for them in urban areas. According to Floriculture Association Nepal, 650 farmers grow flowers and plants nationwide, although they are concentrated in Kathmandu and nearby areas, Chitwan, Jhapa, and Morang[3]. Current cultivation area is 120 hectores in total. Recent data is not available, but their total sales reached 230 million as of 2006. 60% of those engaged in floriculture is said to be women. Major products include bulbs, seedlings, gladioli, roses, garberas, and orchids.

Table 3.1-15 Mushroom Production

| | Fresh Mushroom Production (t) | Seed Production (bottle) |
|---|---|---|
| 2009/10 | 1,100 | 200,000 |
| 2010/11 | 1,530 | 268,560 |

Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information on Nepalese Agriculture 2010/2011 (2067/068)

(9) Livestock

Table 3.1-16 shows the changes in the number of farm animals. Fowls, goat, buffaloes, milking buffaloes, and pigs show double-digit growth between 2005/06 and 2010/11, whereas ducks and sheep population is on the decline.

[3] As of 2006, farmers engaed in floriculture are located in as many as 34 districts.

Table 3.1-16 Livestock Population

(Ton)

| Year | Cattle | Buffaloes | Sheep | Goat | Pigs | Fowl |
|---|---|---|---|---|---|---|
| 2000/01 | 6,982.7 | 3,624.0 | 850.2 | 6,478.4 | 912.5 | 19,790.1 |
| 2005/06 | 7,002.9 | 4,204.9 | 812.1 | 7,421.6 | 960.8 | 23,221.4 |
| 2006/07 | 7,044.3 | 4,366.8 | 813.6 | 7,847.6 | 989.4 | 23,924.6 |
| 2007/08 | 7,090.7 | 4,496.5 | 809.5 | 8,135.9 | 1,013.4 | 24,665.8 |
| 2008/09 | 7,175.2 | 4,680.5 | 803.0 | 8,473.1 | 1,044.5 | 24,481.3 |
| 2009/10 | 7,199.3 | 4,837.0 | 801.4 | 8,844.2 | 1,064.9 | 25,760.4 |
| 2010/11 | 7,226.1 | 4,993.7 | 805.1 | 9,186.4 | 1,108.5 | 39,530.6 |
| Year | Duck | Milking cow | Milking buffaloes | Laying-hen | Laying-duck | |
| 2000/01 | 411.4 | 852.6 | 936.8 | 5,998.4 | 215.4 | |
| 2005/06 | 392.9 | 903.4 | 1,084.8 | 6,769.1 | 183.7 | |
| 2006/07 | 394.8 | 908.7 | 1,124.5 | 6,962.1 | 184.6 | |
| 2007/08 | 390.7 | 915.4 | 1,158.3 | 7,153.1 | 182.8 | |
| 2008/09 | 383.1 | 932.9 | 1,211.5 | 7,124.1 | 179.2 | |
| 2009/10 | 379.8 | 954.7 | 1,252.8 | 7,290.9 | 175.3 | |
| 2010/11 | 378.1 | 974.1 | 1,291.6 | 7,478.6 | 175.2 | |

Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

Table 3.1-17 shows the changes in milk, meat and egg production, which increased during the same period for all the categories except for mutton, duck meats, and duck eggs to reflect the decrease in their populations. Wool production does not show a substantial change but declines moderately in comparison to 2000/01.

Table 3.1-17 Livestock Products

| | Meat (net) production (mt.) | | | | | | |
|---|---|---|---|---|---|---|---|
| | BUFFALO | MUTTON | GOAT | PIG | CHICKEN | DUCK | Total |
| 2000/01 | 124,848 | 2,856 | 37,769 | 15,239 | 13,259 | 287 | 194,258 |
| 2005/06 | 142,040 | 2,737 | 42,820 | 15,773 | 15,605 | 230 | 219,205 |
| 2006/07 | 147,031 | 2,747 | 44,933 | 16,035 | 16,126 | 233 | 227,105 |
| 2007/08 | 151,209 | 2,725 | 46,570 | 16,453 | 16,712 | 231 | 233,900 |
| 2008/09 | 156,627 | 2,711 | 48,472 | 16,992 | 16,662 | 226 | 241,690 |
| 2009/10 | 162,213 | 2,691 | 49,851 | 17,066 | 16,527 | 225 | 248,573 |
| 2010/11 | 167,868 | 2,722 | 52,809 | 17,923 | 36,085 | 218 | 277,625 |
| | Milk (mt.) | | | Egg ('000 number) | | | Wool (kg.) |
| | COW | BUFFALO | Total | HEN | DUCK | Total | |
| 2000/01 | 342,738 | 781,394 | 1,124,132 | 491,566 | 15,757 | 507,323 | 613,824 |
| 2005/06 | 385,290 | 926,850 | 1,312,140 | 587,219 | 13,581 | 600,800 | 586,988 |
| 2006/07 | 392,791 | 958,603 | 1,351,394 | 600,966 | 13,882 | 614,848 | 588,248 |
| 2007/08 | 400,950 | 987,780 | 1,388,730 | 617,455 | 13,798 | 631,253 | 585,255 |
| 2008/09 | 413,919 | 1,031,500 | 1,445,419 | 616,312 | 13,628 | 629,940 | 583,776 |
| 2009/10 | 429,030 | 1,066,867 | 1,495,897 | 629,793 | 13,410 | 643,203 | 579,631 |
| 2010/11 | 447,185 | 1,109,325 | 1,556,510 | 691,070 | 13,065 | 704,135 | 586,232 |

Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

(10) Fishery/aquafarming

Fish production recorded 52,450 tons in 2010/11 (Table 3.1-18). As shown in Table 3.1-19, production from aquaculture amounted to 30,950 tons and accounted for 59% of total, of which 87% (26,941 tons) were raised in ponds.

Table 3.1-18 Fish Production

(Area: Hectare, Production: Metric Ton)

| Year | Pond's no. | Pond's Area | Water Surface Area | Total fish Production | Yield Kg/ha. |
|---|---|---|---|---|---|
| 1990/91 | 17,617 | 8,518 | 5,083 | 8,713 | 1,714 |
| 1995/96 | 18,965 | 8,790 | 5,206 | 10,031 | 1,927 |
| 2000/01 | 22,205 | N.A. | 5,945 | 15,320 | 2,577 |
| 2005/06 | 23,393 | N.A. | 6,337 | 22,545 | 3,558 |
| 2006/07 | 23,627 | N.A. | 6,500 | 23,750 | 3,654 |
| 2007/08 | 23,884 | N.A. | 6,735 | 24,295 | 3,607 |
| 2008/09 | 23,790 | N.A. | 6,700 | 23,780 | 3,549 |
| 2009/10 | 24,418 | N.A. | 6,900 | 24,869 | 3,604 |
| 2010/11 | 26,036 | N.A. | 7,277 | 26,941 | 3,702 |

Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

Table 3.1-19 Fish Production (2010/2011)

| Particulars | Pond (Nos.) | Total Area (Ha.) | Fish Production (Mt.) | YIELD Kg/ha |
|---|---|---|---|---|
| A. Fish Production from Aquaculture Practices | | | 30,950 | |
| A1 Pond Fish culture | 26,036 | 7,277 | 26,941 | 3,702 |
| Mountain | 82 | 4 | 5 | 1,250 |
| Hill | 1,525 | 190 | 337 | 1,774 |
| Terai | 24,429 | 7,083 | 26,599 | 3,755 |
| A2 Other area (ghols) | | 2,200 | 3,300 | 1,500 |
| A3 Paddycum fish culture (Ha) | | 100 | 45 | 450 |
| A4 Cage fish culture (m3) | | 60,000 | 360 | 6 |
| A5 Enclosure fish culture (Ha) | | 100 | 140 | 1,400 |
| A6 Trout Fish Culture in Raceway (m2) | | 5,000 | 140 | 28 |
| A7 Fish Production in Public Sector (M.ton) | | | 24 | |
| B. Fish Production from Capture Fisheries | | | 21,500 | |
| B1 Rivers | | 395,000 | 7,110 | 18 |
| B2 Lakes | | 5,000 | 850 | 170 |
| B3 Reservoirs | | 1,500 | 385 | 257 |
| B4 Marginal/Swamps/ghols etc. | | 11,100 | 5,990 | 540 |
| B5 Irrigated Paddy Fields | | 398,000 | 7,165 | 18 |
| **Total Fish Production (Mt.)** | | | **52,450** | |
| C. Fish Production/Distribution (No. in '000) | | | 108,900 Fry | |
| C1 Public Sector | | | 24,364 | |
| a. Hatchling | | | 125,558 | |
| b. Fry | | | 14,835 | |
| c. Fingerling | | | 6,850 | |
| C2 Private Sector | | | 80,365 | |
| a. Fry | | | 80,365 | |

Source: Ministry of Agriculture and Co-operatives. 2012. Statistical Information On Nepalese Agriculture 2010/2011 (2067/068)

#### 3.1.1.2 Production Relative to the World Production and Trade

The above section has overviewed agriculture production in Nepal according to statistical data collected by the then Ministry of Agriculture and Cooperatives. In the world, production of mustard seed (2nd), ginger (3rd), cardamom (4th), jute (5th), buffalo milk (5th) and lentil (5th) rank high In terms of monetary amounts (Table 3.1-20).

Table 3.1-20 Agricultural Products Ranked High in the World (2010) (in value term)

| Rank | Product |
|---|---|
| 2 | Mustard seed |
| 3 | Ginger |
| 4 | Nutmeg, mace and cardamoms |
| 5 | Buffalo milk, whole, fresh |
| 5 | Jute |
| 5 | Indigenous Buffalo Meat |
| 5 | Lentils |
| 5 | Oilseeds, Nes |
| 6 | Spices, nes |
| 8 | Vegetables fresh nes |
| 8 | Pigeon peas |
| 9 | Fruit Fresh Nes |
| 9 | Arecanuts |
| 10 | Roots and Tubers, nes |
| 12 | Persimmons |
| 12 | Millet |
| 18 | Tangerines, mandarins, clem. |
| 18 | Indigenous Goat Meat |
| 18 | Rice, paddy |
| 19 | Linseed |
| 19 | Tea |

Source: FAO STAT.

As shown in Table 3.1-21, lentil, tea, cardamom, giger has earned a lot of export revenue, recording trade surplus[4]. As for agro processing (or food processing) products, juices are ranked high. According to the interviews by the study team, a large part of export of juices is by Dubar Nepal, and they are produced from imports. Instant noodles (shown as macaroni in the Table), which are made of domestic flour, are also ranked high, but there are no other. Meanwhile, fruits, vegetables and cereals record huge trade deficits (Table 3.1-22). As described at the beginning of this chapter, the agricultural sector occupies an important place in the Nepalese economy. Some products have international competitiveness. Production has been increasing. Overall, however, ths sector has yet to be able to cater for domestic demand or be called an agricultural country from the international trade perspective.

[4] According to AEC, mustard sees are produced for oil extraction for domestic consumption, but Nepal imports them as the production is not large enough.

Table 3.1-21 Top 20 Export Agricultural Products (2010) (in value term)

| | Product | Quantity (tons) | Value (1000 $) | Unit value ($/ton) |
|---|---|---|---|---|
| 1 | Lentils | 37,570 | 51,193 | 1,363 |
| 2 | Tea | 8,498 | 16,340 | 1,923 |
| 3 | Nutmeg, mace and cardamoms | 5,783 | 16,016 | 2,769 |
| 4 | Beverage Non-Alc | 16,419 | 11,604 | 707 |
| 5 | Nuts, nes | 7,978 | 6,549 | 821 |
| 6 | Ginger | 30,416 | 6,234 | 205 |
| 7 | Food Prep Nes | 3,856 | 6,107 | 1,584 |
| 8 | Macaroni | 3,984 | 5,961 | 1,496 |
| 9 | Fruit Juice Nes | 8,278 | 5,747 | 694 |
| 10 | Orange juice, single strength | 6,681 | 4,351 | 651 |
| 11 | Cake of Rapeseed | 14,631 | 3,481 | 238 |
| 12 | Oil of vegetable origin, nes | 2,896 | 2,986 | 1,031 |
| 13 | Apple juice, single strength | 2,995 | 2,250 | 751 |
| 14 | Cake of Oilseeds, Nes | 7,552 | 1,805 | 239 |
| 15 | Food Wastes | 988 | 1,675 | 1,695 |
| 16 | Ghee,Butteroil of Cow Milk | 494 | 1,523 | 3,083 |
| 17 | Juice of Pineapples | 2,504 | 1,490 | 595 |
| 18 | Bran of Wheat | 10,354 | 1,388 | 134 |
| 19 | Cake of Soybeans | 5,039 | 1,248 | 248 |
| 20 | Bran of Cereals | 11,240 | 924 | 82 |

Source: FAO STAT.

Table 3.1-22 Trade Balance of Agricultural Products (2009/2010)

(Rs. Million)

| | Exports | Imports | Surplus/Deficit |
|---|---|---|---|
| Lentils | 3,745 | 230 | 3,515 |
| Tea | 1,195 | 35 | 1,160 |
| Cardamom | 1,172 | 57 | 1,114 |
| Fruit | 486 | 4,715 | -4,228 |
| Ginger | 456 | 46 | 410 |
| Vegetables | 26 | 2,097 | -2,071 |
| Coffee | 24 | 14 | 11 |
| Beans | 11 | 1,379 | -1,368 |
| Sub-total High Value Crops | 7,116 | 8,573 | -1,457 |
| Cereals | 112 | 4,195 | -4,082 |
| MAPs | 440 | Not significant | 440 |
| Dairy products | Not significant | 861 | -861 |

Source: Agrifood Consulting International, Inc.. 2012. TA 7762-NEP Preparation of the Agricultural Development Strategy – Assessment Report.

### 3.1.2 Agricultural Policy

Table 3.1-23 lists development plans and policies relating to agricultural development and acts that are enacted. Among them, Agriculture Perspective Plan (APP), National Agriculture Policy 2004, and Agri-business Promotion Policy 2006, which was formulated on the basis of National Agriculture Policy 2004, are major ones. Three-year Plan 2010/11 – 2012/13 was developed along the lines of APP and National Agricultural Policy 2004. To understand the country's agricultural policy, APP, National Agriculture Policy 2004, and Agri-business Promotion Policy 2006 are outlined below. Note that, they are guidelines according to interviews with stakeholders; to implement listed measures, enacting new acts or revising the current ones are necessary. Furthermore, budgets incentives and rebates have to be secured in annual budgets.

Table 3.1-23 List of Plans, Polices and Acts Related to Agriculture Promotion

| |
|---|
| Development Plans |
| ✓ Three-Year Plan 2010/11-2012/13<br>✓ Agriculture Perspective Plan (APP) 1995/96- 2014/15<br>✓ National Agriculture Sector Development Priority (NASDP) 2010/11 - 2014/15 |
| Policies in Agriculture Sector |
| ✓ National Agriculture Policy, 2061 (2004)<br>✓ Agro-business Promotion Policy, 2064 (2006)<br>✓ National Fertilizer Policy, 2058 (2002)<br>✓ Irrigation Policy, 2060 (2003)<br>✓ National Seed Policy, 2056 (2000)<br>✓ National Tea Policy, 2057 (2000)<br>✓ National Coffee Policy, 2060<br>✓ Dairy Development Policy, 2064 (2007)<br>✓ Agriculture Bio-diversity Policy, 2063 (2007)<br>✓ Trade Policy, 2009 |
| Acts related to the Agricultural Sector |
| ✓ Agriculture and Forestry University Act, 2067 (2010)<br>✓ Animal Health and Livestock Services Act, 2055 (1999)<br>✓ Animal Slaughterhouse and Meat Inspection Act, 2055(1999)<br>✓ Aquatic Animal Protection Act, 2017(1960)<br>✓ Contract Act, 2056 (2000)<br>✓ Cooperatives Act, 2048(1992)<br>✓ National Cooperatives Development Board Act, 2049 (1992)<br>✓ National Dairy Development Board Act, 2048(1992)<br>✓ Drugs Act, 2035, (1978)<br>✓ Feed Act, 2033 (1976)<br>✓ Food Act, 2052 (1996)<br>✓ Forest Act, 2049 (1993)<br>✓ Water Resources Act 2049 (1992)<br>✓ Irrigation Rules, 2056 (2000)<br>✓ Local Self-Governance Act, 2055 (1999)<br>✓ Nepal Agricultural Research Council Act, 2048(1992)<br>✓ The Pesticides Act, 2048 (1991)<br>✓ Plant Protection Act, 2064 (2007)<br>✓ Seeds Act, 2045 (1988)<br>✓ National Tea and Coffee Development Board Act,2049 (1993)<br>✓ Nepal Veterinary Council Act, 2055 (1999) |

Source: Agrifood Consulting International, Inc.. 2012. TA 7762-NEP Preparation of the Agricultural Development Strategy – Assessment Report.

### 3.1.2.1 Agriculture Perspective Plan (APP)

APP aims to raise per capita agricultural growth from 0.5% to 3% over the 20-year period between 1995/96 and 2014/15 and thereby to stimulate growth in non-agriculture sectors, while increasing employment opportunity to lower the poverty rate from 42% in 1991/92 to 14% in 2014/15.

APP sets forth the following objectives and strategies.

<Objectives>

(1) To accelerate the growth rate in agriculture through increased factor productivity.

(2) To alleviate poverty and achieve significant improvement in the standard of living through accelerated growth and expanded employment opportunities.

(3) To transform the subsistence-based agriculture into a commercial one through diversification and widespread realization of comparative advantage.

(4) To expand opportunities for an overall economic transformation by fulfilling the precondition of agricultural development.

(5) To identify immediate, short-term and long-term strategies for implementation, and to provide clear guidelines for preparing periodic plans and programs in future.

<Strategy>

(1) A technology-based green revolution in agriculture becomes the initial engine of accelerated growth.

(2) Accelerated agricultural growth creates a demand pull for the production of high-value commodities in agriculture, as well as for nonagricultural commodities, with consequent large multiplier effects on other sectors of the economy.

(3) Broadly based high employment growth then becomes the mechanism for achieving societal objectives .

(4) Public policy and investment focus on a small number of priorities, building on past investment in human capital and physical and institutional infrastructure .

(5) A package approach to development is introduced, which in Nepal's case would be differentiated for the terai, hills, and mountains, and would recognize the powerful complementarity between public and private investment and priorities, and would ensure their coordination .

(6) To achieve broad participation, the strategy is regionally balanced and explicitly ensures the participation of women .

Specifically, development efforts and resources are devoted to programs relating to irrigation, road construction and rural electrification, promotion of fertilizer use, research and development, and dissemination of modern farming techniques. By implementing these programs in a coordinated and integrated manner, it intends to expand the livestock sector, increase production of higher value added agricultural products, develop agro-business, and preserve forest resources.

Priority products (activities) are vegetables, citrus fruits, apples, vegetable and fruit seeds, honey (apiculture), and cocoons (sericulture), with an emphasis on production in mountain and hill areas.

#### 3.1.2.2 National Agriculture Policy 2004

National Agriculture Policy 2004 was formulated in response to the need for a new agricultural policy to deal with changes surrounding the sector after the launching of APP, e.g., economic liberalization, increased importance of the role of the private sector in economic development, the commitment to the Millennium Development Goals, and the commitment to WTO and regional trade arrangements. The objective of the policy are:

<Objective>

To contribute to the task of ensuring food security and poverty alleviation by achieving a high and sustainable economic growth a commercial and competitive farming system[5].

To accomplish the above objective, the policy sets forth 57 programs according to the following:

(1) Agricultural production and productivity shall be increased.
(2) The bases of a commercial and competitive farming system shall be developed and made competitive in the regional and world markets.
(3) Natural resources, as well as the environment and bio-diversity, shall be conserved, promoted and properly utilized.

National Agriculture Policy 2004 follows the objectives and strategies of APP as seen in the programs such as comprehensive development of infrastructure facilities (irrigation system, roads and electricity) and priority development of high value added agricultural products in the area along the north-south arterial roads and its branch networks. Furthermore, special support for small farms, farms without access to irrigation, and those in Dalit[6], expansion of insurance service for farm animals, introduction of insurance for poultry farming and high value added agricultural products, and promotion of organic farming are included.

#### 3.1.2.3 Agri-Business Promotion Policy 2006

Agri-business Promotion Policy 2006 has been formulated to accelerate promotion of commercial farming activity, which is one of the key objectives of National Agriculture Policy 2004, and sets forth the following objectives.

<Objectives>

(1) To assist market-oriented and competitive agricultural production

[5] Sic.
[6] Dalit is a designation for a group of people traditionally regarded as untouchable.

(2) To contribute to capturing domestic markets and export promotion by developing agro-industry
(3) To assist poverty alleviation through agri-business

To achieve these objectives, a variety of programs are conceived, including construction of agri-business support centers, markets and product pickup points, development of infrastructure facilities including farm roads, lowering of tariff rates on agricultural machines and implements, preferential electricity tariffs, and exemption of land ceiling. Also, an idea of developing commercial farming zones, organic farming zones, and export-oriented farming zones with linkage to Special Economic Zones is presented.

### 3.1.3 Issues in the Agricultural Sector

(1) Shortage of agricultural inputs

A major factor causing low productivity is insufficient use of inputs such as improved seeds and fertilizer. The situation has not improved much since 1995/96 when the APP had started. For example, seed turnover remains 8 %, meaning that the majority of farmers use seeds obtained from their own fields. The fertilizer distributed through formal distribution channels has lost ground to cheaper informal imports whose prices are curbed by Indian subsidies. As a result, the formal supply is smaller than that in the 1990's[7]. Worse, some fertilizer obtained from informal channels is said to be inferior in quality, causing farmers to refrain from using fertilizer[8]. The amount of fertilizer used including that obtained through informal channels is not clear, and yet, as far as the JICA Study Team interviewed, it is in short.

(2) Underdevelopment of infrastructure

The area where irrigation is available reached 1.227 million hectares as of 2010. Yet, the estimated area covered by all-year irrigation is 450 thousand hectares, which is almost same as that in 1995. In addition, the area with all-year irrigation does not necessarily achieve higher yields due to poor agricultural practice and insufficient use of improved seeds and fertilizer. Road development is also lagging behind, preventing farmers from growing and shipping perishable products.

(3) Traditional farming methods

Adoption of better agricultural practices has been delayed, because research and development activities responding to farmers' needs are insufficient and agricultural extension services are not readily available. According to commodity associations the JICA Study Team visited, farmers keep growing crops in traditional methods or do so by looking at how other people are doing, not knowing newer and better practices. Insect damage and/or diseases spreading in production of

[7] For example, 185,797 tons were supplied in 1991/92, 133,250 tons in 1995/96. In 2009/10, the supply was 9,500 tons.
[8] In some cases, famers use fertilized in a wrong way

coffee, cardamom, and lentils, etc., are not addressed well. Yields of coffee are much lower than other countries, while Nepal has failed to cater for demand from foreign buyers[9].

(4) Small-scaleness

Many point out that a factor leading to structural constraints is that many Nepalese farmers are small-scale. Being small-scale, farmers grow crops primarily for subsistence and sell only surplus products. They grow multiple crops to reduce risks, and those who need to find other income generating activities do not necessarily pay good attention to farming. As a result, they collectively tend to grow cereals while producing others only in a small amount, and the quality of harvests collected from them are not uniform. Cooperatives are active, but due to constraints in scale, facilities, capability, networks and etc., many of them have yet to collect a large amount or keep the quality of products uniform.

(5) Underdevelopment of down stream industry and delay in establishing transaction relationships

Value adding activities are uncommon. A large part of agricultural exports, especially those sent to India, are unprocessed at all or proccessed only a little; cardamom is largely exported just after drying, and later processes including cutting, grading, cleaning are conducted in Siliguri in West Bengal; although some are dried before exported, exported raw ginger is largely unwashed and washed in Gorakhpur, Uttar Pradesh or drilectly sold at the Indian local market[10].

The agricultural sector are not well connected to the food processing industry. Providing domestic processors with their products is not common either, though there are some such examples as selling potetoes to a factory producing potato chips. A reason is that down stream industry has not developed much; no factory (or few if any) produces ginger powder or oil. On the other hand, a juice factory the JICA Study Team visited uses domestic fruits and yet is not able to procure sufficient amount. As already described, small-scaleness of farmers is a constraint; they do not concentrate on growing a single cash crop partly in order to mitigate the risk of lean harvest resulting from unfavorable climate conditions and/or diseases as well as the risk of price fluctuations. In addition, another reason is said to be that there is not stable buyers. From buyers' perspective, on the other hand, contract farming does not work because farmers are likely to sell whoever buy at a higer price even if they reach an transaction agreement in advance.

(6) Underdevelopment of agribusiness

Contract farming seems to be more likely to work if farming is done as an enterprise activity. To make supplies stable to develop OVOPs or local specialties, production as an agri-business is desirable. However, while individual farmers and cooperatives are exempt from taxes, agribusinesses have to pay corporate tax and employees also have to pay income tax,

9 Yields of tea leaves are also said to be lower than India by 25% and Sri Lanka by 30%

10 Construction of a ginger processing plant has been determined.

which inhibits farming as an enterprise activity. In addition, some argue that financial services are not accessible even if they want to make investment to boost productivity.

These issues are widely recognized by those involved in agriculture, both in the public and private sectors. However, they have not been addressed well, because financial resources, human resources and coordination are lacking in the government and acts to implement policies and measures does not pass smoothly.

## 3.2 Mining Sector

### 3.2.1 Current State

In Nepal, presence of fossil fuel resources, including coal, petroleum, natural gas, and methane, has been confirmed but they have still to be commercially developed. Peat, lignite and coal reserves have been known for long time and 19 mines are currently exploited on a small scale. For instance, coal production amounts to meager 100 – 200 tons per day.

Mining policy is formulated and implemented by Department of Mines and Geology, an extra-departmental body of the Ministry of Industry. The department has 207 staff members and issues prospecting licenses according to Mines and Mineral Act, 2042 (1985) and Mines and Mineral Regulations, 2056 (1999). There are two types of licenses, namely “prospecting license” and “mining license.” The former covers a project to develop mineral resources which reserve and grade has not been confirmed, while the latter is granted to a project developing resources with a known reserve and grade on the basis of DoMG’s phased surveys.

In FY2012, 489 prospecting licenses were issued, of which 308 were reissued to renew previously issued licenses and 190 were newly granted. In the same year, 79 mining licenses were issues, of which 74 were for renewal and 5 for new projects.

By type of mineral resource covered by the licenses, limestone (as a material for cement making) held the largest share. For prospecting licenses, limestone projects totaled 139 for renewal and 45 for new issuance. Similarly, the number mining licenses covering limestone was 29 for renewal and one for a new project. Although small in number in comparison to lime stone, ten or more licenses were issued to projects covering iron ores, gold dust, gold, copper, coal, and tourmaline[11].

Since 1982, the Nepali government has been promoting petroleum development as one of its major projects. Ten prospective blocks have been selected. Royal Dutch Shell is exploring Block No.10 in the east and has drilled a prospecting well to 3,520 meters without success. Texana Resource Company of the U.S. is working in Block Nos. 3 and 5, and Carin Energy PLC of the UK in Block Nos. 1, 2, 4,6 and 7.Then, at the end of 2012, a UAE company decided to undertake exploratory survey in Block Nos.8 and 9, and a U.S. company in Block No.10. As a result, all the ten blocks are investigated by foreign companies, although no drilling has been started.

As for methane gas, prospecting has been made in a 26 $km^2$ area within the Kathmandu Valley under technical support by JICA’s to Department of Mines and Geology, and reserves

[11] Source:`Annual Report No.8 DMG`, Department of Mines and Geology, April 2012

totaling 316 million cubic meters have been confirmed. In 1996, a feasibility study was carried out in a separate project, which confirmed that available methane gas could be used for commercial (household) and industrial purposes. Then, the government invited bids for a development and commercialization project five times but no bid was offered (still can be accepted).

On the other hand, two companies had shown interest in development of natural gas resources, but they have already withdrawn for a high cost and the lack of commercial viability due to the requirement for installation of pipelines and other conditions attached to commercial development.

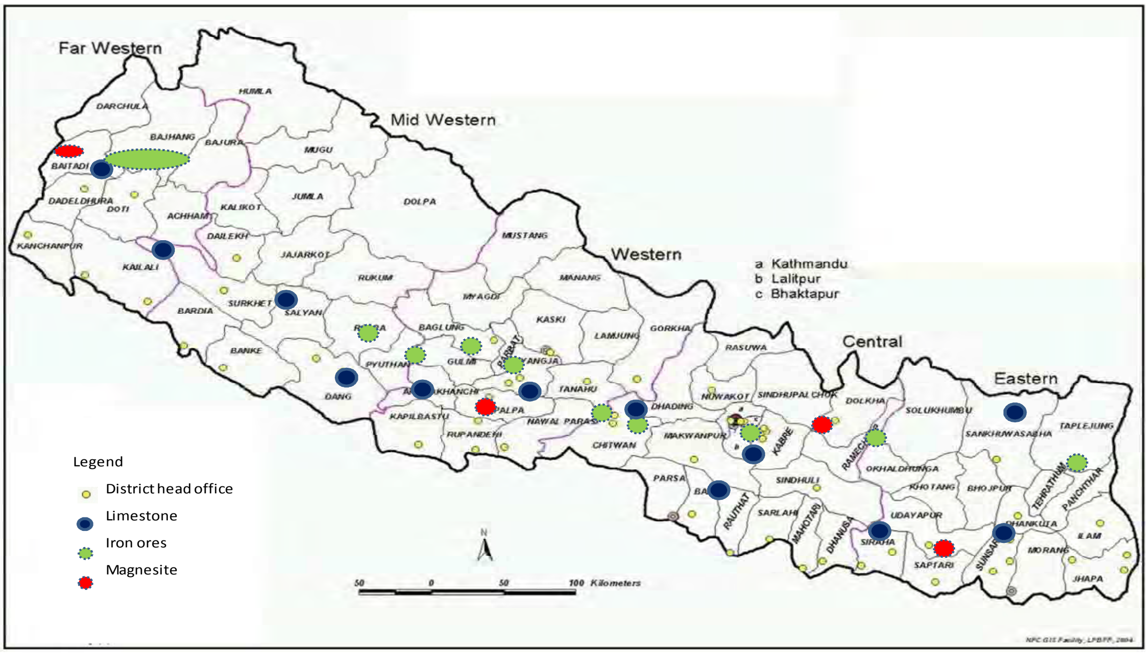
Table 3.2-1 summarizes four major zones showing a high prospect for mineral resources exploitation.

Table 3.2-1 Potential Mineral Resources

| Zone | Minerals |
|---|---|
| Inner Himalayas-Tibetan Tethys Zone (Late Proterozoic to Early Cenozoic) Highest part of Mountain along Tibet | ● Mainly sand stones, limestone, shale, fairly rich in fossils<br>● Prospective for salt, gypsum, phosphorite, limestone and natural gas<br>● Black shale could be favourable REE<br>● Ex.Burning of natural gas in Muktinath Temple, salt encrustation in Nursing Khoka, Mustang |
| Higher Himalaya Zone (Precambrian) ie. Mountain | ● High grade metamorphic rocks and migmalites<br>● Leuco-granite of Tertiary age<br>● Prospective for lead, zinc, tin, uranium, limestone, gemstones like ruby, sapphire, aquamarine, garnet, kainite, sillimanite<br>● Granites are favourable for Sn, W, U, REE<br>● Ex.Ganesh Himal Lean Zinc >grade 14.66%zinc, 3.01% lead and 23.5g/ton silver and tonnage of 2.4 million tons |
| Lesser Himalaya Zone (Mahabharata Range and Mid Valleys) ie. Hill | ● Largely un-fossiliferous meta-sedimentary rocks of Precambrian age<br>● Crystalline nappes intruded by granite bodies of Ordovician age<br>● Some fossiliferous rocks of Permo/carboniferous to Oligocene age (Palpa, Dang and Surkhet areas)<br>● Main rock types: limestone, dolomite, quartzite, slate, phyllite, schist, gniss, amphibolites, granite, syenite, etc<br>● Potential for Metals : Cu, Fe, Pb, Zn, Sn, W, Mo, Co, Ni, Bi, Au, Ag, U, etc<br>● Potential for Non-metals : marble, limestone, dolomite, phosphorite, magnesite, talc, semi precious stone, ie., kyanite, garnet, tourmaline, quartz, etc<br>● Pegmatities are favourable for REE<br>● Limestone potential reserve : > 1,500 million tons |
| Sub Himalaya Zone (Chure/Siwalik Range) ie. Between Hill and Terai | ● Thick sequence of molasses sediments of mid Miocene to upper Pleistocene age<br>● Sandstone, shale, siltstone, conglomerate<br>● Potential for: U, REE and Petroleum resources |

Source: FNCCI, 'Nepal Fertile Land for Investment'

Mineral resources for which ore reserves have been confirmed are iron, copper, zinc, lead, cobalt, nickel, gold, silver, tin, and tungsten. Non-metallic minerals resources are limestone, magnesite, dolomite, phosphorite, talc, quartz, mica, clay, silica sand, gemstones, decorative and dimension stones, and construction materials. Furthermore, ore reserves for semi-precious stones, including garnet, tourmaline, aquamarine, and beryl, and precious stones such as ruby and sapphire, have been confirmed.




Source: `Mineral Resources of Nepal` Department of Mines and Geology, 2011

Figure 3.2-1 Geographical Distribution of Prospective Natural Resources in Nepal

Fig.3.2-1 shows geographical distribution of limestone, iron ore and magnesite resources that are identified by the DoMG as prospective minerals. As seen in the map, iron ore and limestone reserves are mainly found in the central and west regions, generally crossing the hilly zone in an east-west direction. On the other hand, magnesite reserves are dispersedly located in the far-western, western, central, and eastern regions.

According to the director and other officials of the DoMG, limestone, magnesite and iron ores are commercially exploitable resources in the country. Limestone has proven reserves of 1.25 billion tons. High quality limestone suitable for cement production is found in Diyarigad, Chaukene, Katari-Galtar, Narpani, Nigale, Kazeri, and Dnag, where cement manufacturers are already operating. Also, exploratory surveys are underway in Udayapur, Khotang, Syangja, Dang, Rolpa, and Palpa. In particular, large deposits have been found in Surkhet and Palpa, with the proven reserves of 300 million tons (according to a 2009 survey) and 200 million tons (a 2012 survey), respectively. For these deposits, private companies have obtained license from the DoMG and are conducting survey.

At present, local sources account for 35% of cement demand in the country[12]. On the other hand, there is high prospect for a large dolomite reserve – estimated at around 5 billion tons – in the Lesser Himalaya region.

As for magnesite, an estimated 100 million ton reserve has been confirmed in Dolakha. A private company is planning to undertake exploratory survey, but it is suspended due to technical and financial problems. Finally, iron ore reserves have been confirmed in Godawari and Nawarparsi, totaling 50 million tons.

At present, the following categories of mineral reserves have been found in the country.

- Metal: 21 items
- Chemical, fertilizer, insulator, ceramics, insoluble substance, polisher: 23 items
- Precious stone: 6 items
- Construction materials: 9 items
- Fuel and geothermal heat source: 4 items

Thus, the country has a wide variety of mineral resources in addition to fossil fuels, including limestone, various metals and precious stones, some of which amount to significant reserves. However, significant investment in development of these resources has not made, either foreign or local, largely because of high cost that is generated by combination of insufficient infrastructure, instable power supply, and low labor productivity. Also, mineral resource development in the Himalayan region is highly restricted due to environmental consideration.

[12] While the country has rich reserves of high quality limestone, which can be used for cement production, low productivity of production and transportation makes it more economical to make import from India.


Source : `Mineral Resources of Nepal` Department of Mines and Geology, 2011

Figure 3.2-2 Hot Spring in Nepal

Hot spring is scattered about as it is indicated at Table 3.3-2. Among these spots, it concentrates on Rasuwa, Darchula, Bajhang, Kaski and Myagdi District. In Raswa district, there are hot springs in Thumman, Lande Khola and Parang. In Darchula District, there are hot springs in Sirbari,Sina and Barpata. In Bajhang District it is found in Joeligad, Chainpur and Bauligad. In Kaski there are four spots like Nayagaon,Seti Khola,Chitepani-1 and Chitepani-2. In Myagdi, it is known that there are hot springs in Myagdi,Kali Gendaki and Sekeharku[13].

### 3.2.2 Mineral Sector Policy

The legal system concerning mineral resources is divided into two categories, namely petroleum and non-petroleum. The legal framework for non-petroleum exploration and development is founded on Mines and Mineral Act, 2042 (1985) with First Amendment and Mines and Mineral Regulations, 2056 (1999). On the other hand, petroleum exploration and development is regulated by Nepal Petroleum Act, 2040 (1983) and Petroleum Regulation, 2041 (1985) (with two amendments). Petroleum development projects are led by Department of Mines and Geology.

[13] The size of circle on the map indicates the size of hot spring on the spot. However, the number of hot springs does not necessarily coincide with the number of the circles. These circles just indicate the approximate geographic location of hot springs.

### 3.2.3 Mineral Sector Development Issues

There are the following four issues relating to commercial development of mineral resources in Nepal.

First of all, shortage of electricity constitutes a major bottleneck, as seen in other industries. Unstable electricity supply necessitates use of diesel construction equipment, which is more costly. Secondly, infrastructure – such as roads and water supply – is not well developed to require mining companies to build it by themselves in some cases. Thirdly, it is difficult to use explosives for mining. Although use of explosives is not prohibited by law, it often faces opposition by local community, which can easily develop to a social problem. The situation also leads to a higher mining cost. The fourth bottleneck is a high land price. Although the real estate bubble bursted in 2009, land prices in areas where mineral reserves have been found remain at relatively high levels, which discourage investors.

Meanwhile, development of limestone and iron mines is highly expected to meet increasing demand for construction materials by the construction industry. Commercial development of huge limestone deposits totaling an estimated 2 billion tons (proven reserve) is expected to substitute cement imports. Many companies, mainly local ones, have already started projects to develop limestone mines for cement production. On the other hand, another prospective mineral – magnesite – has a variety of applications, including heat-proof bricks for high output furnaces, production of magnesium and magnesia, and fertilizers.

To promote use of these productive minerals for development of the private sector, however, it is crucial to ensure understanding and agreement on the mining project by stakeholders from the planning stage. For instance, there is more than one case when a cement manufacturer has attempted to develop a limestone mine that it owned but was forced to close it as a result of strong opposition by local residents that became a political problem. It is important to minimize the development risk by providing benefits for local communities and promoting their understanding, which leads to smooth implementation of the development project.

In a natural resource development project in other country, a company explained that the project would be implemented for a specific period of time by specifying estimated reserves and took a lead in provision of vocational training for local residents in preparation for the end of the project, as well as entrepreneurship support. Such efforts have also resulted in the improvement of the natural environment where the project took place.

## 3.3 Industrial Sector

### 3.3.1 General Outline of the Industrial Sector

In Nepal, the industrial sector emerged in the 1950s but is stll at the early stage of development. Its growth is leveling off in recent years, with its GDP share declining from 7.9% in 2004/05 to 6.2% in 2010/11. The following sections analyze the current state of the industrial sector.

#### 3.3.1.1 Statistical Analysis of Companies by Sector and Size

In Nepal, mid-sized and large enterprises are registered with the Department of Industry (DOI) in any of the seven industrial sectors defined in the Industrial Enterprises Act 1992, namely agriculture and forestry based industry, manufacturing, energy, mining, tourism, construction, and service. The act also defines size classification of companies, i.e., medium-sized enterprises have fixed assets of more than Rs.30 million and Rs.100 million or less, and large enterprises more than Rs.100 million (see 3.3.1.2 for details). In addition, smaller enterprises established by foreign capital need to be registered with the DoI.

On the other hand, cottage and small enterprises are registered with either of two organizations under the MoI, namely the Department of Cottage and Small Scale Industry (DoCSI) covering 27 districts in the Terai region or the Cottage and Small Industries Development Board (CSIDB) serving 48 districts in the hilly and mountain and Himalaya regions. Registration is made for any of the above seven categories. As the seven sectors plus intormation technology are covered in Industrial Policy 2010 formulated by the MoI, “industry” under the Nepalese government’s definition covers these eight sectors. Yet, currently, the Industrial Enterprises Act 1992 which specifies the seven sectors is still in effect. The term “industry” thus refers to these sectors. The following analysis of the MoI’s statistics first outlines the industry as a whole and then focuses on the manufacturing sector. Note that other statistics relating to companies are the Census of Manufacturing Establishment (CME) and the Survey of Small Manufacturing Establishments (SSME) published by the Bureau of Statistics. CME covers manufacturing establishments having 10 or more engaged persons and its survey is conducted every five years, and SSME covers those with less than 10 engaged persons and is published every ten years. The most recent CME survey was conducted in 2006/07 and SSME in 2008/09. Analysis of these statistical data is presented in ANNEX-1 of this report.

(1) Medium-sized and large enterprises registered with DoI

The DOI has accepted corporate registration applications from an accumulated total of 4,552 companies up until 2010/11 (Note that the registration data include small companies owned by foreign investors.). Table 3.3-1 shows geographical distribution of registered companies. The largest number of companies is registered in Kathmandu, totaling 2,167 and accounting for nearly one half of the total. Lalitpur (416) and Kaski (189) come next to Kathmandu. A large number of enterprises are also registered in Morang where an industrial city Biratnagar is located as well as in Parsa which accommodates another industrial city Birgunj and its neighboring district Bara, and Chitwan which is a tourist site. On the other hand, no company registration has been made in some districts.

Table 3.3-1 District-wise Number of Medium-sized and Large Industries Registered up to 2010/11*

| | District | No. of Industries | Total Project Cost (Million Rupees) | Total Fixed Cost (Million Rupees) | Total No. of Employee |
|---|---|---|---|---|---|
| 1 | Achham | 4 | 1,072 | 1,050 | 257 |
| 2 | Arghakhachi | 1 | 18 | 13 | 50 |
| 3 | Baglung | 2 | 449 | 436 | 119 |
| 4 | Baitadi | 2 | 20 | 17 | 202 |
| 5 | Banke | 54 | 5,266 | 4,032 | 4,126 |
| 6 | Bara | 178 | 27,204 | 17,678 | 19,820 |
| 7 | Bardiya | 9 | 220 | 205 | 294 |
| 8 | Bhaktapur | 124 | 5,280 | 3,954 | 12,530 |
| 9 | Bheri zone | 1 | 15 | 15 | 20 |
| 10 | Bhojpur | 4 | 1,147 | 132 | 222 |
| 11 | Chitwan | 122 | 9,793 | 6,824 | 7,751 |
| 12 | Dadeldhura | 1 | 87 | 83 | 30 |
| 13 | Dailekh | 1 | 210 | 200 | 31 |
| 14 | Dang | 21 | 5,489 | 5,071 | 3,087 |
| 15 | Dang, salyan | 1 | 6,200 | 6,000 | 273 |
| 16 | Darchula | 1 | 34 | 32 | 60 |
| 17 | Dhading | 36 | 9,440 | 8,810 | 2,626 |
| 18 | Dhankuta | 16 | 2,180 | 1,856 | 2,742 |
| 19 | Dhanusha | 24 | 2,469 | 2,148 | 2,207 |
| 20 | Dolakha | 13 | 44,408 | 44,107 | 5,227 |
| 21 | Dolpa | 1 | 5 | 4 | 21 |
| 22 | Doti | 3 | 12,180 | 12,072 | 99 |
| 23 | Gorkha | 13 | 1,276 | 1,235 | 691 |
| 24 | Gulmi | 3 | 721 | 668 | 90 |
| 25 | Humla | 4 | 36 | 33 | 84 |
| 26 | Ilam | 22 | 5,376 | 4,423 | 5,183 |
| 27 | Jhapa | 75 | 5,208 | 4,480 | 13,233 |
| 28 | Kailali | 23 | 2,622 | 1,411 | 2,452 |
| 29 | Kalikot | 1 | 1,900 | 1,800 | 115 |
| 30 | Kanchanpur | 19 | 1,415 | 1,124 | 2,835 |
| 31 | Kapilvastu | 20 | 3,461 | 2,932 | 2,707 |
| 32 | Kaski | 189 | 21,097 | 18,646 | 10,990 |
| 33 | Kaski,Rupandehi | 1 | 238 | 221 | 36 |
| 34 | Kathmandu | 2,167 | 85,586 | 58,685 | 185,656 |
| 35 | Kavre | 108 | 4,840 | 3,757 | 9,381 |
| 36 | Khotang | 1 | 30 | 11 | 13 |
| 37 | Lalitpur | 416 | 18,393 | 14,254 | 27,590 |
| 38 | Lamjung | 13 | 20,593 | 19,869 | 1,075 |
| 39 | Mahottari | 4 | 997 | 843 | 767 |
| 40 | Makwanpur | 75 | 8,413 | 6,267 | 7,469 |

| District | | No. of Industries | Total Project Cost (Million Rupees) | Total Fixed Cost (Million Rupees) | Total No. of Employee |
|---|---|---|---|---|---|
| 41 | Morang | 184 | 13,491 | 9,317 | 15,684 |
| 42 | Mugu | 1 | 42 | 39 | 50 |
| 43 | Mustang | 2 | 356 | 336 | 150 |
| 44 | Myagdi | 1 | 5,590 | 5,466 | 32 |
| 45 | Nawalparasi | 77 | 10,063 | 7,665 | 7,667 |
| 46 | Nuwakot | 19 | 878 | 800 | 988 |
| 47 | Palpa | 2 | 43 | 33 | 30 |
| 48 | Panchathar | 5 | 813 | 781 | 2,235 |
| 49 | Panchthar | 1 | 52 | 37 | 327 |
| 50 | Parbat | 2 | 120 | 116 | 231 |
| 51 | Parsa | 122 | 9,758 | 5,637 | 11,038 |
| 52 | Ramechhap | 2 | 543 | 262 | 170 |
| 53 | Rasuwa | 7 | 6,141 | 5,916 | 1,680 |
| 54 | Rautahat | 4 | 62 | 47 | 109 |
| 55 | Rolpa | 3 | 1,023 | 972 | 4,066 |
| 56 | Rupandehi | 140 | 15,475 | 11,473 | 14,531 |
| 57 | Sankhuwasava | 5 | 977 | 883 | 1,135 |
| 58 | Saptari | 9 | 577 | 474 | 962 |
| 59 | Sarlahi | 13 | 1,490 | 1,200 | 1,531 |
| 60 | Sindhuli | 2 | 204 | 195 | 195 |
| 61 | Sindhupalchok | 23 | 10,420 | 10,126 | 1,652 |
| 62 | Siraha | 7 | 1,032 | 843 | 600 |
| 63 | Solukhumbu | 22 | 4,329 | 4,200 | 1,419 |
| 64 | Sunsari | 99 | 9,002 | 6,754 | 11,818 |
| 65 | Surkhet | 4 | 155 | 23 | 220 |
| 66 | Syangja | 3 | 31 | 35 | 459 |
| 67 | Tanahu | 8 | 447 | 365 | 628 |
| 68 | Taplejung | 5 | 654 | 634 | 205 |
| 69 | Tehrathum | 2 | 182 | 171 | 76 |
| 70 | Udaypur | 5 | 5,854 | 5,297 | 764 |
| | Total | 4,552 | 415,192 | 335,492 | 412,813 |

*Note: Figures include the number of registrations submitted to the Department of Industry for foreign investment for small enterprises
The top ten districts in terms of the number of registration are shaded.
Source: Department of Industry. Industrial Statistics Fiscal Year 2067/068 (2010/2011)

In CME 2006/07 which cover manufacturing establishments with 10 or more engabed persons also, Kathmandu is ranked first in terms of the number of establishments (480 out of 3,446) and that of engaged persons (23,411 out of 177,550) (see ANNEX-I for details). Yet, the proportion the district occupies are just over 10% in both elements, and thus a large part of the registerd companies in Kathumandu shown in Table 3.3-1 are estimated to be in non-manufacturing sectors. What is distinct in the manufacturing sector in Kathmandu is that many of them (271 out of 240) are in textiles. Accumulation of Indian enterprises are also in the district. Note that the ranking in terms of the number of establishments is not so different from that shown in Table 3.3-1; in CME 2006/07 also, disticts in the Terai such as Morang and Rupandehi, and Kathmandu and its neighboring districts occupy top 10. In terms of value added, Kathumandu is ranked third; Bara comes first, followed by Nawalparasi, and Morang is in the fourth. Figure 3.3-1 shows districts ranked among top 10 in CME 2006/07 in terms of either the number of establishments, engaged persons, or value added. The figure also shows major manufacturing sectors in each.

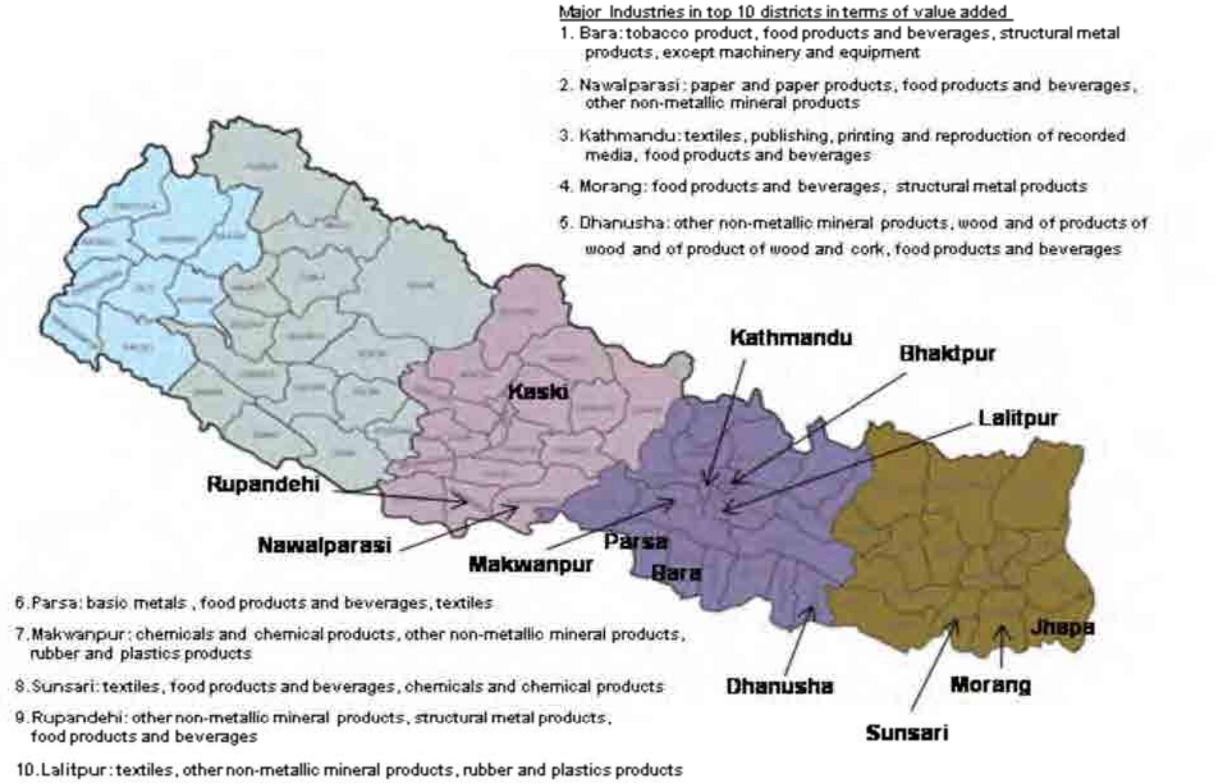



Figure 3.3-1 CME 2006/07: Top 10 Districts in terms of the Number of Establishments, Engaged People, and Value Added

Of 4,552 companies registered up to 2010/11 shown in Table 3.3-1, data on medium-sized and large enterprises are summarized by category in Table 3.3-2. 1,553 companies have registered and the manufacturing sector accounts for the largest share of 46.2%, or 718 companies (191 large enterprises and 527 medium-sized enterprises), followed by the service sector (426 companies, 27.4%) and tourism (207 companies, 13.3%). These percentage shares are more or less the same for breakdown by the number of employees. The manufacturing sector's employment reaches 99,320 in total. Note that these data include companies that have already ceased to operate. It should be taken into account when these data are analyzed, although an exact number of companies in operation are not known.

Table 3.3-2 Category-wise Number of Medium-sized and Large Industries Registered up to 2010/11

| Category | Scale | No. of Industries | Total Project Cost (Million Rupees) | Total Fixed Cost (Million Rupees) | Total No. of Employment |
|---|---|---|---|---|---|
| Agro Based | Large | 17 (1.1%) | 3,867.7 | 3,986.4 | 2,658 |
| | Medium | 79 (5.1%) | 5,123.2 | 4,297.5 | 17,064 |
| | Total | 96 (6.2%) | 8,991 | 8,284 | 19,722 |
| Construction | Large | 8 (0.5%) | 4,859.3 | 4,775.6 | 737 |
| | Medium | 10 (0.6%) | 517.3 | 414.7 | 580 |
| | Total | 18 (1.2%) | 5,377 | 5,190 | 1,317 |
| Energy Based | Large | 63 (4.1%) | 125,402.0 | 121,905.8 | 10,759 |
| | Medium | 14 (0.9%) | 2,254.7 | 904.2 | 1,303 |
| | Total | 77 (5.0%) | 127,657 | 122,810 | 12,062 |
| Manufacturing | Large | 191 (12.3%) | 86,520.5 | 69,615.4 | 43,986 |
| | Medium | 527 (33.9%) | 43,441.3 | 27,059.3 | 55,334 |
| | Total | 718 (46.2%) | 129,962 | 96,675 | 99,320 |
| Mineral | Large | 4 (0.3%) | 2,988.0 | 2,658.5 | 714 |
| | Medium | 7 (0.5%) | 298.4 | 268.2 | 781 |
| | Total | 11 (0.7%) | 3,286 | 2,927 | 1,495 |
| Service | Large | 88 (5.7%) | 43,962.9 | 31,407.8 | 13,968 |
| | Medium | 338 (21.8%) | 24,152.1 | 16,238.9 | 35,108 |
| | Total | 426 (27.4%) | 68,115 | 47,647 | 49,076 |
| Tourism | Large | 69 (4.4%) | 22,852.9 | 20,896.1 | 7,742 |
| | Medium | 138 (8.9%) | 8,099.4 | 7,252.4 | 8,313 |
| | Total | 207 (13.3%) | 30,952 | 28,148 | 16,055 |
| Grand Total | | 1,553 (100%) | 374,340 | 311,681 | 199,047 |

Source: Department of Industry. Industrial Statistics Fiscal Year 2067/068 (2010/2011)

For the one-year period in 2010/11, 85 midsized and large enterprises were registered. Of total, 39 companies (29 medium-sized and 10 large enterprises) belonged to the manufacturing sector, representing 45.9% of the total. These companies created 3,202 jobs (Table 3.3-3).

Table 3.3-3 Number of Medium-sized and Large Manufacturing Industries Registered in 2010/11

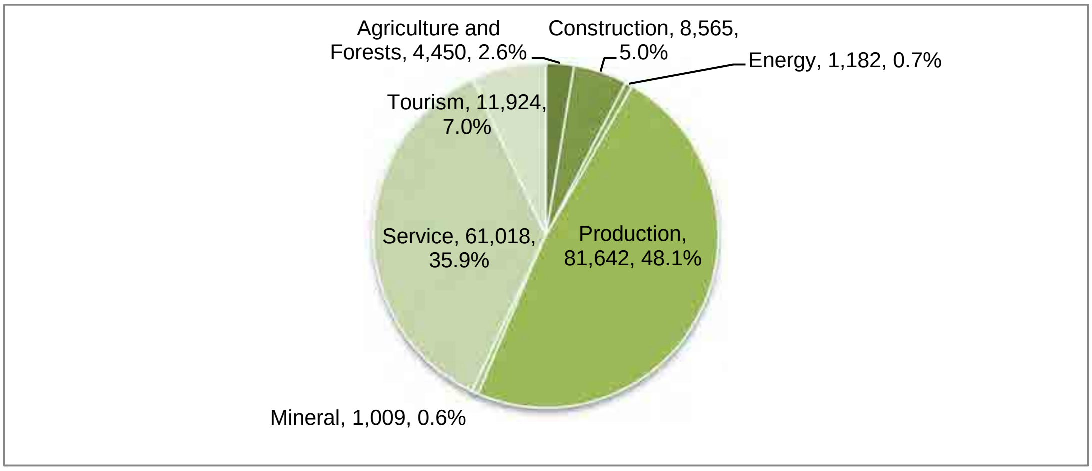
| | No. of Industries | Total Project Cost (Million Rupees) | Total Fixed Cost (Million Rupees) | Total No. of Employee |
|---|---|---|---|---|
| Large | 10 | 4406.15 | 3701.8 | 1,264 |
| Medium | 29 | 2792.23 | 1614.23 | 1,938 |
| Total | 39 | 7198.38 | 5316.03 | 3,202 |

Source: Department of Industry. Industrial Statistics Fiscal Year 2067/068 (2010/2011)

(2) Cottage and small enterprises registered with DoCSI and CSIDB

According to Industrial Enterprises Act 1992, small companies having fixed assets of Rs.30 million or less and traditional cottage industries as separately defined in the act – namely, those using traditional skills, technology and/or local resources[14] - are registered with a district office of CoSCI or CSIDB (excepting small enterprises ownedby foreign investors). As shown in Figure 3.3-2, a total of 169,790 cottage and small enterprises were registered between 1994/95 and 2010/11[15], and around the half of them are in the production sector. Among them, 125,419 companies maintained registration as of 2010/11[16] (Tables 3.3-4 and 3.3-5). Of total, 10,562 companies were classified as cottage industries and 114,857 as small industries (which are not shown in the tables).

Among the cottage and small enterprises who maintained registration, the largest number is found in the service sector (57,668, 46.0%), followed by the manufacturing sector (45,594, 36.4%). Among districts, Kathmandu accommodates over 20% of the total (27,853), and the top ten districts are all located in the region under DoCSI's jurisdiction (Terai region, districts around Kathmandu, and Kaski). On the other hand, the least number of registered companies is found in Manang (84), and all the lowest ten districts are located under CSIDB's jurisdiction. As a result, the number of small companies registered with DoCSI amounts to 98,151 and accounts for 57.8% of the total, despite a smaller number of districts under DoCSI's jurisdiction. Notably, a higher percentage of companies registered in the CSIDB's districts is engaged in agriculture or forestry (8.5% vs. the national average of 3.9%) to reflect the fact that they are located in the hilly and mountain regions, whereas a percentage of small companies engaged in manufacture is lower (22.4% vs. the national average of 36.4%).




Source: Ministry of Industry

Figure 3.3-2 Category-wise Number of Cottage and Small Industries Registered (1994/95-2010/11)

[14] Industrial Enterprises Act 1992 classify companies that use traditional skills, technology and/or machinery and equipment using or incorporate locally available materials and are engaged in type of businesss relating to Nepal's indigenous culture or art as traditional cottage industries. Note that the act does not define cottage industries, while Industrial Policy 2010 has the one.

[15] When looking further back, the number of registered companies totals 215,336. Note that cottage industries including traditional industries.

[16] Note that registration does not necessarily mean that the company actual conducts business activity.

Table 3.3-4 Number of Cottage and Small Enterprises Maintaining the Registration Status at DoCSI (as of 2010/11)

| | District | Category | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Agriculture & Forests | Construction | Energy | Production | Mineral | Services | Tourism | Total |
| ***1*** | ***Jhapa*** | ***124*** | ***207*** | ***14*** | ***2,188*** | ***3*** | ***1,376*** | ***78*** | ***3,990*** |
| ***2*** | ***Morang*** | ***34*** | ***485*** | ***3*** | ***1,729*** | ***1*** | ***1,214*** | ***22*** | ***3,488*** |
| ***3*** | ***Sunsari*** | ***59*** | ***0*** | ***2*** | ***1,205*** | ***0*** | ***1,388*** | ***42*** | ***2,696*** |
| 4 | Saptari | 15 | 27 | 0 | 454 | 16 | 1,028 | 3 | 1,543 |
| 5 | Siraha | 53 | 163 | 4 | 1,588 | 8 | 305 | 10 | 2,131 |
| ***6*** | ***Dhanusha*** | ***31*** | ***0*** | ***2*** | ***817*** | ***0*** | ***1,682*** | ***30*** | ***2,562*** |
| 7 | Mahottari | 39 | 189 | 2 | 453 | 7 | 911 | 3 | 1,604 |
| 8 | Sarlahi | 1 | 118 | 0 | 527 | 0 | 1,097 | 9 | 1,752 |
| 9 | Rautahat | 69 | 202 | 0 | 529 | 0 | 676 | 33 | 1,509 |
| 10 | Bara | 25 | 5 | 2 | 872 | 0 | 1,020 | 2 | 1,926 |
| ***11*** | ***Parsa*** | ***49*** | ***448*** | ***0*** | ***1,854*** | ***0*** | ***1,492*** | ***6*** | ***3,849*** |
| 12 | Makwanpur | 65 | 0 | 0 | 881 | 0 | 1,077 | 76 | 2,099 |
| ***13*** | ***Chitwan*** | ***510*** | ***3*** | ***10*** | ***2,036*** | ***0*** | ***1,056*** | ***350*** | ***3,965*** |
| ***14*** | ***Kathmandu*** | ***343*** | ***86*** | ***111*** | ***7,533*** | ***0*** | ***13,068*** | ***6,712*** | ***27,853*** |
| ***15*** | ***Lalitpur*** | ***76*** | ***43*** | ***6*** | ***4,206*** | ***0*** | ***3,396*** | ***170*** | ***7,897*** |
| 16 | Bhaktapur | 95 | 3 | 0 | 1,079 | 0 | 771 | 229 | 2,177 |
| 17 | Kavre | 327 | 0 | 8 | 401 | 0 | 1,206 | 138 | 2,080 |
| ***18*** | ***Kaski*** | ***174*** | ***0*** | ***0*** | ***1,580*** | ***0*** | ***2,013*** | ***1,316*** | ***5,083*** |
| 19 | Palpa | 19 | 0 | 0 | 193 | 0 | 475 | 85 | 772 |
| 20 | Nawalparasi | 130 | 0 | 6 | 927 | 0 | 661 | 619 | 2,343 |
| ***21*** | ***Rupandehi*** | ***85*** | ***8*** | ***1*** | ***3,303*** | ***0*** | ***1,500*** | ***862*** | ***5,759*** |
| 22 | Kapilvastu | 8 | 0 | 0 | 1,213 | 0 | 749 | 21 | 1,991 |
| 23 | Dang | 0 | 237 | 4 | 685 | 0 | 908 | 0 | 1,834 |
| 24 | Banke | 42 | 4 | 0 | 1,156 | 1 | 521 | 97 | 1,821 |
| 25 | Bardiya | 41 | 0 | 0 | 532 | 0 | 779 | 21 | 1,373 |
| 26 | Kailali | 83 | 45 | 3 | 970 | 2 | 1,269 | 69 | 2,441 |
| 27 | Kanchanpur | 51 | 0 | 0 | 568 | 0 | 933 | 61 | 1,613 |
| **DoCSI Sub-Total** | | **2,548 (2.6%)** | **2,273 (2.3%)** | **178 (0.2%)** | **39,479 (40.2%)** | **38 (0.0%)** | **42,571 (43.4%)** | **11,064 (11.3%)** | **98,151 (100%)** |
| **DoCSI + CSIDB Total** | | **4,873 (3.9%)** | **4,585 (3.7%)** | **291 (0.2%)** | **45,594 (36.4%)** | **114 (0.1%)** | **57,668 (46.0%)** | **12,294 (9.8%)** | **125,419 (100%)** |

Note: Top ten districts in terms of the number of registrations are shaded.
Source: Department of Cottage and Small Scale Industry. Industrial Promotion Statistics 2011.

Table 3.3-5 Number of Cottage and Small Enterprises Maintaining the Registration Status at CSIDB (as of 2010/11)

| | District | Category | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Agriculture & Forests | Construction | Energy | Production | Mineral | Services | Tourism | Total |
| 28 | Illam | 164 | 0 | 22 | 46 | 3 | 476 | 4 | 715 |
| ***29*** | ***Taplejung*** | ***48*** | ***1*** | ***2*** | ***47*** | ***1*** | ***161*** | ***3*** | ***263*** |
| 30 | Panchthar | 57 | 101 | 4 | 85 | 0 | 137 | 4 | 388 |
| 31 | Dhankutta | 61 | 5 | 2 | 137 | 3 | 355 | 13 | 576 |
| 32 | Sakhuwasabha | 53 | 37 | 1 | 93 | 6 | 259 | 17 | 466 |
| 33 | Terathum | 61 | 64 | 3 | 96 | 0 | 195 | 4 | 423 |
| 34 | Bhojpur | 20 | 1 | 0 | 102 | 1 | 185 | 0 | 309 |
| 35 | Udaypur | 25 | 0 | 0 | 175 | 1 | 555 | 10 | 766 |
| 36 | Khotang | 28 | 2 | 2 | 65 | 0 | 278 | 4 | 379 |
| ***37*** | ***Solukhumbu*** | ***52*** | ***21*** | ***6*** | ***60*** | ***1*** | ***122*** | ***18*** | ***280*** |
| 38 | Okhaldhunga | 48 | 0 | 2 | 38 | 0 | 212 | 5 | 305 |
| 39 | Dolakha | 36 | 23 | 1 | 114 | 3 | 344 | 28 | 549 |
| 40 | Ramechhap | 67 | 1 | 4 | 144 | 9 | 307 | 32 | 564 |
| 41 | Sindhuli | 52 | 2 | 0 | 140 | 4 | 382 | 0 | 580 |
| 42 | Sindhupalchok | 97 | 154 | 3 | 98 | 5 | 661 | 27 | 1,045 |
| 43 | Nuwakot | 154 | 2 | 0 | 424 | 7 | 530 | 28 | 1,145 |
| ***44*** | ***Rasuwa*** | ***32*** | ***15*** | ***0*** | ***50*** | ***1*** | ***154*** | ***15*** | ***267*** |

| | District | Category | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Agriculture & Forests | Construction | Energy | Production | Mineral | Services | Tourism | Total |
| 45 | Dhading | 135 | 163 | 2 | 226 | 7 | 839 | 7 | 1,379 |
| 46 | Tanahu | 161 | 104 | 4 | 468 | 2 | 636 | 246 | 1,621 |
| ***47*** | ***Manang*** | ***2*** | ***2*** | ***0*** | ***16*** | ***5*** | ***40*** | ***19*** | ***84*** |
| 48 | Gorkha | 64 | 22 | 10 | 139 | 7 | 520 | 85 | 847 |
| 49 | Lamgunj | 62 | 4 | 8 | 231 | 3 | 435 | 0 | 743 |
| 50 | Syangja | 8 | 94 | 5 | 693 | 2 | 217 | 5 | 1,024 |
| 51 | Baglung | 87 | 49 | 3 | 93 | 1 | 422 | 119 | 774 |
| 52 | Gulmi | 19 | 0 | 0 | 168 | 1 | 534 | 101 | 823 |
| 53 | Myagdi | 54 | 71 | 0 | 65 | 0 | 268 | 32 | 490 |
| ***54*** | ***Mustang*** | ***33*** | ***33*** | ***1*** | ***17*** | ***0*** | ***59*** | ***30*** | ***173*** |
| 55 | Parvat | 45 | 80 | 0 | 142 | 0 | 396 | 86 | 749 |
| 56 | Arghakhachi | 39 | 86 | 2 | 124 | 0 | 397 | 2 | 650 |
| 57 | Puithan | 8 | 1 | 5 | 78 | 0 | 525 | 8 | 625 |
| 58 | Salyan | 12 | 137 | 1 | 67 | 0 | 273 | 29 | 519 |
| 59 | Rolpa | 34 | 70 | 0 | 53 | 0 | 398 | 37 | 592 |
| 60 | Rukhum | 22 | 97 | 1 | 182 | 0 | 105 | 0 | 407 |
| 61 | Surkhet | 96 | 2 | 1 | 484 | 2 | 786 | 3 | 1,374 |
| 62 | Dailekh | 13 | 38 | 0 | 233 | 0 | 391 | 98 | 773 |
| 63 | Kalikot | 36 | 6 | 5 | 103 | 0 | 337 | 9 | 496 |
| 64 | Jajarkot | 31 | 55 | 1 | 31 | 0 | 201 | 1 | 320 |
| 65 | Jumla | 76 | 6 | 1 | 58 | 0 | 259 | 27 | 427 |
| ***66*** | ***Mugu*** | ***18*** | ***20*** | ***4*** | ***55*** | ***1*** | ***185*** | ***15*** | ***298*** |
| ***67*** | ***Dolpa*** | ***7*** | ***2*** | ***0*** | ***20*** | ***0*** | ***206*** | ***0*** | ***235*** |
| ***68*** | ***Humla*** | ***18*** | ***74*** | ***0*** | ***17*** | ***0*** | ***78*** | ***8*** | ***195*** |
| 69 | Doti | 12 | 132 | 3 | 31 | 0 | 117 | 12 | 307 |
| 70 | Aacham | 45 | 148 | 0 | 21 | 0 | 132 | 6 | 352 |
| ***71*** | ***Bajura*** | ***7*** | ***80*** | ***2*** | ***74*** | ***0*** | ***117*** | ***1*** | ***281*** |
| 72 | Bajhang | 29 | 1 | 0 | 156 | 0 | 290 | 25 | 501 |
| 73 | Baitadi | 39 | 126 | 0 | 81 | 0 | 222 | 3 | 471 |
| 74 | Dadeldhura | 28 | 88 | 2 | 38 | 0 | 286 | 4 | 446 |
| ***75*** | ***Darchula*** | ***30*** | ***92*** | ***0*** | ***37*** | ***0*** | ***113*** | ***0*** | ***272*** |
| **CSIDB Sub-Total** | | **2,325 (8.5%)** | **2,312 (8.5%)** | **113 (0.4%)** | **6,115 (22.4%)** | **76 (0.3%)** | **15,097 (55.4%)** | **1,230 (4.5%)** | **27,268 (100%)** |
| **DoCSI + CSIDB Total** | | **4,873 (3.9%)** | **4,585 (3.7%)** | **291 (0.2%)** | **45,594 (36.4%)** | **114 (0.1%)** | **57,668 (46.0%)** | **12,294 (9.8%)** | **125,419 (100%)** |

Note: Bottom ten deistircts in terms of the number of registrations are shaded.
Source: Department of Cottage and Small Scale Industry. Industrial Promotion Statistics 2011.

Figure 3.3-3 shows top 10 districts in terms of the number of cottage and small enterprises mainitaining registration. Similarly, Figure 3.3-4 shows 10 districts in the bottm.


Source: Department of Cottage and Small Scale Industry. Industrial Promotion Statistics 2011.

Figure 3.3-3 Top 10 Districts in terms of the Number of Registered Cottage and Small Enterprises


Source: Department of Cottage and Small Scale Industry. Industrial Promotion Statistics 2011.

Figure 3.3-4 Bottom 10 Districts in terms of the Number of Registered Cottage and Small Enterprises

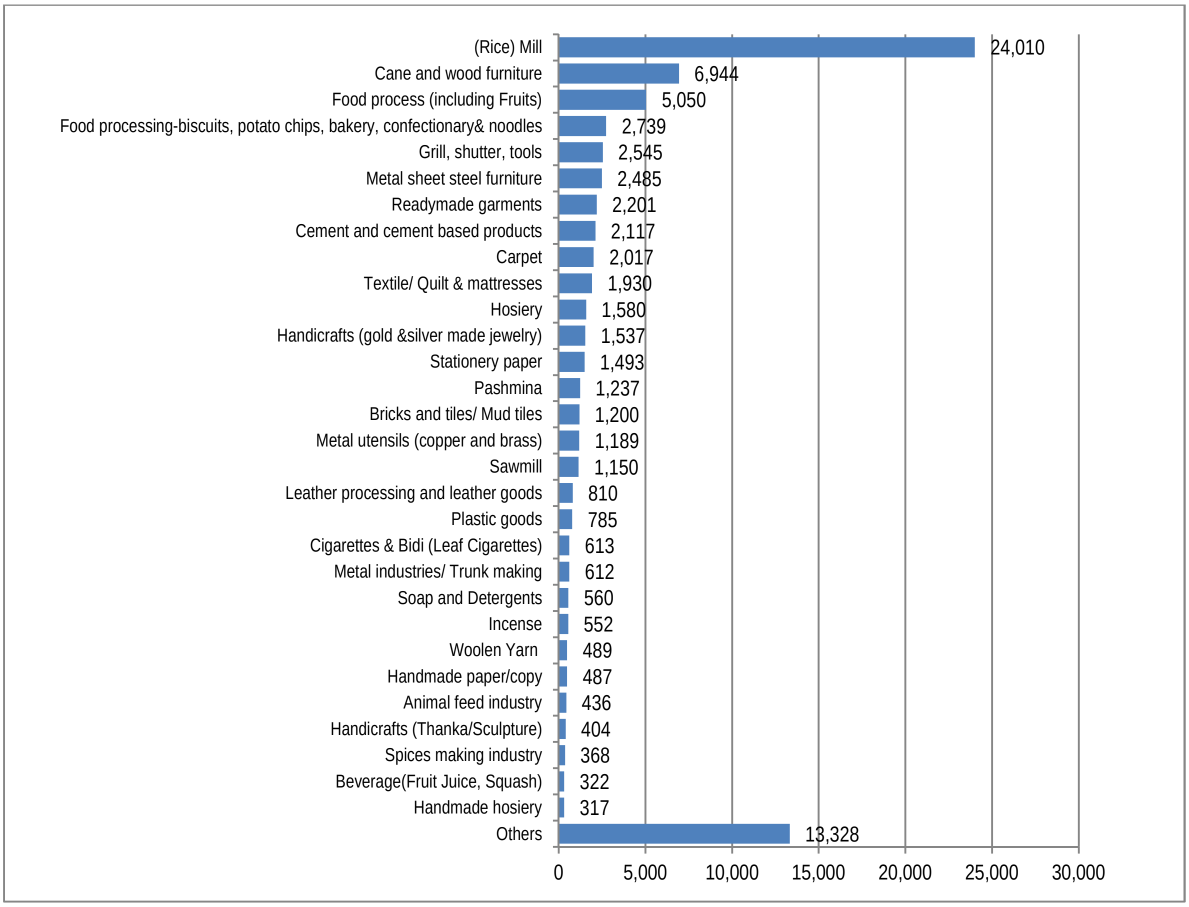
In 2010/11, 14,678 industries, including those registered and re-registered. (Table 3.3-6).

Table 3.3-6 Cottage and Small Industries Registered in 2010/11

| | | |
|---|---|---|
| No of Industries registered | | 14,678 |
| No. of Entrepreneurs | Female | 2,822 |
| | Male | 15,918 |
| | Total | 18,740 |
| Proposed Employment No. | Female | 8,956 |
| | Male | 63,962 |
| | Total | 72,918 |
| Capital Investment | Operating Capital | 7,398,726 |
| | Fixed Capital | 6,993,993 |
| | Total | 14,750,911 |
| Annual Production in 000 Rs. | | 36,786,410 |

Source: Department of Cottage and Small Scale Industry. Industrial Promotion Statistics 2011.

Figure 3.3-5 shows the number of small manufacturing establishments registered in the top 30 sub-sectors (out of 103 in total). Of 81,642 companies registered, rice mills account for nearly 30% (24,010 companies), followed by furniture, food processing, textile/quilt/mattress, metal products, and handicrafts. The top ten industries (including textile/quilt/mattress) represent 63.7% of the total and the top 30 industries 83.5%. Thus, these industries dominate small manufacturing companies in Nepal. Note that tourism mostly consists of hotels and travel/trekking agents, while small companies in the agriculture and forestry sector are mostly engaged in farming including cultivation of tea leaves, livestock farming including poultry, and cultivation of nursery trees. Various businesses are registered in the service industry too, not as varied as in the manufacturing sector though. Areas in which many service enterprises are engaged include training centers, legal or technical consulting, computer training, tailoring, and engineering service.




Source: Department of Cottage and Small Scale Industry. Industrial Promotion Statistics 2011.

Figure 3.3-5 Top 30 Business Categories of Small Registered Manufacturing Industries

All in all, analysis of the corporate registration data indicates, together with a relatively small number of companies, that the service sector has high share that corresponds more or less to the country's GDP composition, while the manufacturing sector holds a high percentage of medium-sized and large enterprises (718 in total)[17].

### 3.3.1.2 Industrial Production Data

Table 3.3-7 shows the production trend in major industrial products published by the government. Although the data are interrupted, they represent a list of industrial products that are manufactured within the country. The table indicates steady growth of various products, including noodles, squash, sugar, tea, liquor, shoes, plywood, plastic products, and steel reinforced aluminum conductors. On the other hand, textile and related products are clearly on the declining

[17] On the basis of DOI's corporate registration data (grand total of 4,552 medium-sized and large enterprises as of 2012) and the Bureau of Statistics data in 2007 (3,446 companies with 10 or more employees)(see Annex I), the number of medium-sized and large enterprises that are conducting business seem to fall below 4,000.

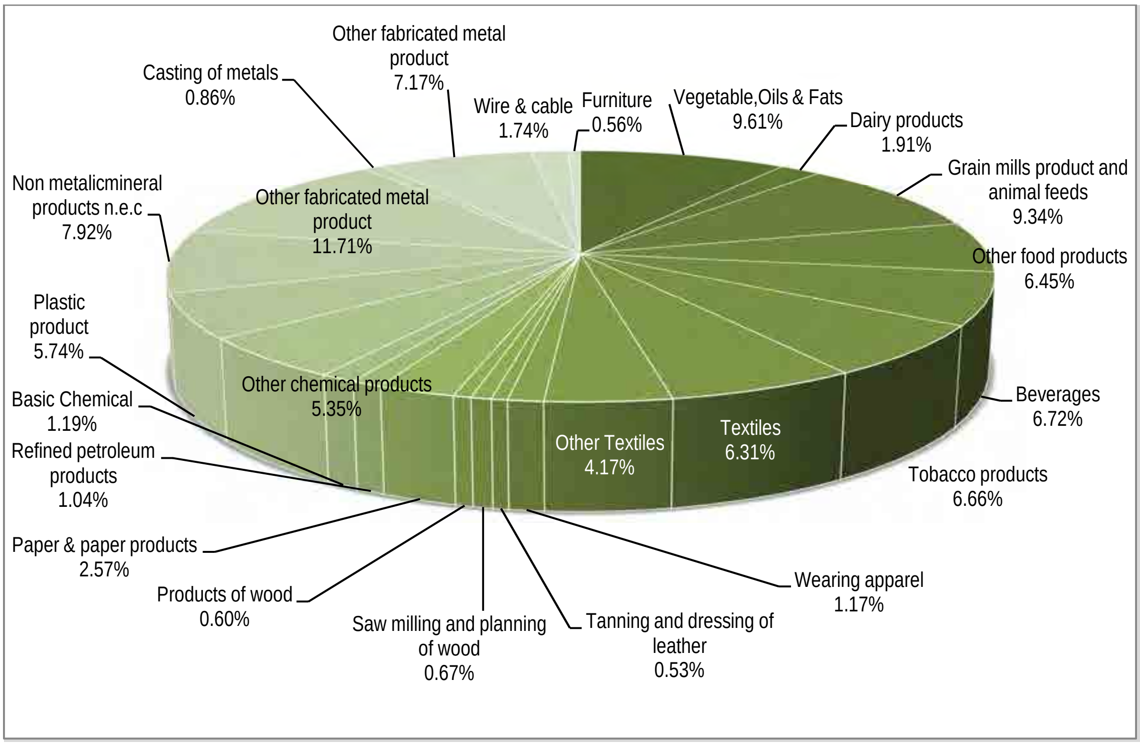
trend, which is also evidenced by export and import statistics. Finally, production of wood and cement has been decreasing because of heightened concerns about environmental protection.

## Table 3.3-7 Production of Major Goods

| | Code No. | Major Industry Group | Unit | 2001/02 | 2002/03 | 2003/04 | 2004/05 | 2005/06 | 2006/07 | 2007/08 | 2008/09 | 2009/10 | 2010/11 | 2011/12* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| 1 | **311-312** | **Food Manufacturing** | | | | | | | | | | | | |
| | 42.3 | I Noodles | M.T. | 7,200 | 8,950 | 9,460 | 29,369 | 32,334 | 35,567 | 37,034 | 40,669 | 42,000 | 42,840 | 44,982 |
| | 48.42 | II Biscuits | M.T. | 9,440 | 9,836 | 9,590 | 6,157 | | | | | | | |
| | 54.5 | III Squash | Th. Litre | 2,250 | 2,430 | 2,612 | 28,905 | 30,350 | 31,867 | 33,580 | 36,894 | 38,794 | 39,580 | 41,559 |
| | 61.2 | IV Sugar | M.T. | 82,200 | 94,052 | 96,174 | 94,436 | 98,461 | 103,384 | 108,682 | 180,650 | 190,650 | 190,650 | 200,183 |
| | 74.11 | V Tea | M.T. | 8,770 | 9,631 | 11,397 | 11,475 | 11,589 | 12,168 | 12,703 | 15,506 | 16,000 | 16,320 | 17,136 |
| | 81.98 | VI Animal Feeds | M.T. | 22,266 | 24,060 | 22,496 | | | | | | | | |
| | 91.4 | VII Vegetable Ghee | M.T. | 99,000 | 75,210 | 72,051 | 199,587 | 179,239 | 188,200 | 194,319 | | | | |
| 2 | **313** | **Beverage Industries** | | | | | | | | | | | | |
| | 111.02 | I Soft Drinks | Th. Litre | 27,100 | 31,603 | 32,472 | 46,283 | | | | | | 15,434 | 15,743 |
| | 112.3 | II Beer | Th. Litre | 22,800 | 24,162 | 24,977 | 30,663 | | | | | | 3,847 | 3,924 |
| | 112.4 | III Liquor | Th. Litre | 3,700 | 3,792 | 4,437 | 8,947 | 9,039 | 9,490 | 10,089 | 11,907 | 12,000 | 12,800 | 13,056 |
| 3 | **314** | **Tobacco Manufacturing** | | | | | | | | | | | | |
| | 122.2 | I Cigarette | Mil. Sticks | 6,900 | 6,812 | 7,268 | 9,418 | 949 | 997 | 1,071 | 12,007 | 13,100 | 13,490 | 13,895 |
| | 122.3 | II Bidi | Mil. Sticks | 150 | 140 | 139 | | | | | | | | |
| 4 | **321** | **Manufacture of Textiles** | | | | | | | | | | | | |
| | 652.1 | I Cotton Clothes | Metre | 1,700 | 1,438 | 1,503 | | | | | | | | |
| | 653.5 | II Synthetic Clothes | Metre | 26,100 | 28,594 | 31,239 | 11,794 | | | | | | 11,793 | |
| | | III Jute Goods | M.T. | 31,400 | 34,862 | 35,699 | 32,780 | | | | | | | |
| 5 | **323** | **Leather & Leather Products** | | | | | | | | | | | | |
| | 611.2 | I Processed Leather | Sq. Ft. | 3,184 | 3,120 | 3,076 | | | | | | | | 14,915 |
| 6 | **324** | **Footwear Manufacturing** | | | | | | | | | | | | |
| | 851 | I Shoes | Th. Pairs | 744 | 786 | 865 | 1,416 | 2,037 | 2,138 | 2,295 | 2,515 | 2,590 | 2,720 | 2,965 |
| 7 | **331** | **Wood & Wood Products** | | | | | | | | | | | | |
| | 634.2 | I Plywood | Sq. Ft. | 632 | 510 | 545 | 603 | 679 | 712 | 753 | 809 | 909 | 950 | |
| | | II Straw Board | M.T. | 1,195 | 1,024 | 1,186 | 813 | 829 | 870 | 907 | 803 | 905 | 950 | 1,045 |
| 8 | **341** | **Paper & Paper Products** | | | | | | | | | | | | |
| | 641.9 | I Paper | M. T. | 41,000 | 42,056 | 42,835 | 28,958 | 29,904 | 31,399 | 32,905 | | | | |
| 9 | **352** | **Manufacture of Other** | | | | | | | | | | | | |
| | 554.1 | I Soap | M. T. | 55,900 | 54,624 | 53,805 | 44,267 | 44,821 | 47,062 | 49,092 | 51,092 | 52,000 | 53,100 | 55,755 |
| | 554.3 | II Detergent Powder | M. T. | 5,008 | 5,241 | 6,195 | 3,301 | 3,331 | 3,497 | 3,705 | 3,800 | 4,305 | 4,435 | 4,657 |
| | 99.32 | III Matches | Gross | 2,320 | 2,150 | 2,053 | 1,598 | | | | | | | |
| 10 | **355** | **Manufacture of Rubber** | | | | | | | | | | | | |
| | 851.01 | I Slipper | Th. Pairs | 5,100 | 4,420 | 4,707 | | | | | | | | 5,065 |
| 11 | **356** | **Manufacture of Plastic** | | | | | | | | | | | | |
| | 581 | I Plastic Goods | M. T. | 1,615 | 1,587 | 1,500 | 6,179 | 6,017 | 6,317 | 6,494 | 65,004 | 66,100 | 68,100 | 73,548 |
| 12 | **369** | **Other Non Metallic** | | | | | | | | | | | | |
| | 661.2 | I Cement | M. T. | 233,000 | 255,171 | 279,412 | 610,044 | 613,643 | 644,325 | 71,132 | 71,000 | 72,100 | 84,130 | 92,543 |
| | 662.41 | II Bricks & Tiles (Govt.Sector) | Th. Piece | 25,500 | 28,954 | 29,967 | | | | | | | | |
| 13 | **371** | **Manufacture of Cutlery** | | | | | | | | | | | | |
| | 673 | I Iron Rod. Angles etc. | M. T. | 140,000 | 154,621 | 169,310 | 166,451 | | | | | | 35,340 | 40,641 |
| 14 | **381** | **Manufacture of Cutlery,** | | | | | | | | | | | | |
| | 697.21 | I Steel Utensils | M. T. | 58 | 66 | 88 | 89 | | | | | | | |
| | | II Agricultural Tools | M. T. | | | | | | | | | | | |
| 15 | **383** | **Manufacture of** | | | | | | | | | | | | |
| | 723.1 | I Wires/Cables | | | | | | | | | | | | |
| | | a. GI/HB Wires | MT | 24,000 | 26,234 | 25,578 | 24,977 | 24,924 | 26,170 | 28,004 | 28,005 | 29,001 | | |
| | | b. ACSR Conductor/PVC | KM | 12,369 | 14,500 | 14,138 | 14,638 | 14,659 | 15,391 | 15,907 | 16,000 | 17,205 | 17,550 | 20,183 |
| | 729.11 | II Dry Cell Battery | Th. Nos. | 48,000 | 53,405 | 51,803 | 54,047 | | | | | | | |

* Annual estimate based on the data of first eight month
Note: Blank space represents unavailability of data
Some data/description seem to be wrong, but they are kept same as the original.
Source: Ministry of Finance.2012. Economic Survey Fiscal Year 2011/12

Figure 3.3-6 shows the composition of the production index (2008/09=100).




Source: Ministry of Finance.2012. Economic Survey Fiscal Year 2011/12

Figure 3.3-6 Composition of the Production Index (2008/09=100)

Table 3.3-8 shows the recent changes in production index for major industrial products. In comparison with the previous Production index whose base year is 2003/04, three items, namely synthetic fiber blend garments, pashmina, and newspaper were removed from the product basket, while 13 items (bread, chocolate, plywood, corrugated cardboard, lube oil, rosin, paint, concrete, Hume pipes, galvanized iron pipes, aluminum products, metal structure, and furniture) were added. Meanwhile, composition weight was decreased for vegetable/animal oil (from 15.78% to 9.61%), other fibers and garments (6.59% to 3.17%), garments (7.17% to 1.17%), and chemical products (10.34% to 5.35%). As pashmina was removed from the product basket, the index no longer includes knitted products. The above changes are designed to reflect actual production activities. In fact, many products that were subject to exclusion or weight reduction showed stagnant production between 2003/04 – 2008/09 (production declined in most cases). For example, in the previous production index, the production index for vegetable oil dropped to 72.69 and that for carpets to 79.64 in 2008/09. On the other hand, the composition weight for other metallic products was raised by 15.18 percentage points in total, while a new category “wood products” was created with the addition of plywood (using imported wood) to the basket. After 2008/09, production of other metallic products has been steadily growing, with addition of three items (GI pipes, aluminum products, and metal structures) to the basket, showing the diversification of the manufacturing industry. Among the product categories for which the composition weight was lowered at the time of the renewal of the base year, garments and chemical products show some recoveries (116.74 and 110.65), whereas vegetable/animal oil and other textile record sluggish production (94.81 and 92.90, respectively, as of 2010/11).

## Table 3.3-8 Production Index (2008/09=10/11)

| S.N. | CPC | Overall Index of Manufacturing Production | Weights* (%) | 2008/09 | 2009/10 | 2010/11 |
|---|---|---|---|---|---|---|
| **1** | | **Manufacture of Vegetable,Oils & Fats** | **9.61** | **100** | **98.08** | **94.81** |
| | 2160 | Vegetable ghee | 5.72 | 100 | 91.82 | 71.74 |
| | 2163 | Mustard oil | 1.32 | 100 | 107.85 | 99.08 |
| | 2165 | Soybean oil | 2.57 | 100 | 106.97 | 143.94 |
| **2** | | **Manufacture of dairy products** | **1.91** | **100** | **109.87** | **108.17** |
| | 2211 | Processed Milk | 1.91 | 100 | 109.87 | 108.17 |
| **3** | | **Grain mills product and animal feeds** | **9.34** | **100** | **91.95** | **99.08** |
| | 2316 | Rice | 7.79 | 100 | 89.37 | 97.42 |
| | 2311 | Wheat flour | 1.39 | 100 | 104.82 | 105.57 |
| | 2331 | Animal feed | 0.16 | 100 | 105.88 | 122.83 |
| **4** | | **Manufacture of other food products** | **6.45** | **100** | **89.2** | **107.77** |
| | 2342 | Biscuit | 0.94 | 100 | 103.3 | 94.57 |
| | 2341 | Bread | 1.07 | | 83.85 | 128.12 |
| | 2353 | Sugar | 1.82 | 100 | 52.53 | 117.06 |
| | 2665 | Chocolate | 0.73 | | 102.85 | 100.65 |
| | 2372 | Noodles | 1.17 | 100 | 113.19 | 110.5 |
| | 2391 | Processed tea | 0.72 | 100 | 118.59 | 74.07 |
| **5** | | **Manufacture of beverages** | **6.72** | **100** | **124.12** | **135.84** |
| | 2412 | Liquor rectified | 2.21 | 100 | 108.49 | 132.94 |
| | 2423 | Beer | 2.38 | 100 | 151.63 | 152.88 |
| | 2449 | Soft drink | 2.13 | 100 | 109.56 | 119.78 |
| **6** | | **Manufacture of tobacco products** | **6.66** | **100** | **101.78** | **125.08** |
| | 2501 | Cigarette | 6.66 | 100 | 101.78 | 125.08 |
| **7** | | **Manufacture of textiles** | **6.31** | **100** | **93.88** | **70.84** |
| | 2621 | Yarn | 1.5 | 100 | 74.59 | 55.97 |
| | 2669 | Cotton clothes | 4.81 | 100 | 99.9 | 75.47 |
| **8** | | **Manufacture of other Textiles** | **4.17** | **100** | **89.29** | **92.9** |
| | 2721 | Woolen carpet | 2.91 | 100 | 93.74 | 78.76 |
| | 2715 | Jute goods | 1.26 | 100 | 79.02 | 125.57 |
| **9** | | **Manufacture of wearing apparel** | **1.17** | **100** | **115.24** | **116.74** |
| | 2825 | Garment | 1.17 | 100 | 115.24 | 116.74 |
| **10** | | **Manufacture of tanning and dressing of leather** | **0.53** | **100** | **155.65** | **100.87** |
| | 2912 | Processed leather | 0.53 | 100 | 155.65 | 100.87 |
| **11** | | **Manufacture of saw milling and planning of wood** | **0.67** | **100** | **109.52** | **58.66** |
| | 3110 | Wood sawn | 0.67 | 100 | 109.52 | 58.66 |
| **12** | | **Manufacture of products of wood** | **0.6** | | **112.61** | **116.3** |
| | 3141 | Ply wood | 0.6 | | 112.61 | 116.3 |
| **13** | | **Manufacture of paper & paper products** | **2.57** | **100** | **94.97** | **77.3** |
| | 3214 | Paper excluding newsprint | 0.57 | 100 | 75.69 | 68.96 |
| | 3215 | cartoon box | 2 | | 100.51 | 79.69 |
| **14** | | **Manufacture of refined petroleum products** | **1.04** | **100** | **105.56** | **111.57** |
| | 3338 | Lube Oil | 1.04 | 100 | 105.56 | 111.57 |
| **15** | | **Manufacture of Basic Chemical** | **1.19** | | **111.3** | **106.51** |
| | 3441 | Rosin | 1.19 | | 111.3 | 106.51 |
| **16** | | **Manufacture of other chemical products** | **5.35** | **100** | **100.89** | **110.65** |
| | 3511 | paint | 0.75 | | 105.28 | 149.93 |
| | 3529 | Medicine | 1.63 | 100 | 100.06 | 113.34 |
| | 3532 | Soap | 2.97 | 100 | 100.24 | 99.26 |
| **17** | | **Manufacture of plastic product** | **5.74** | **100** | **101.71** | **94.1** |
| | 3641 | plastic product | 5.74 | 100 | 101.71 | 94.1 |
| **18** | | **Non metalicmineral products n.e.c** | **7.92** | **100** | **104.48** | **133.63** |
| | 3735 | Bricks | 1.62 | 100 | 88.13 | 77.48 |
| | 3744 | Cement | 5.28 | 100 | 114.69 | 161.66 |
| | 3769 | concrete | 0.76 | | 43.64 | 40.54 |
| | 3756 | Hume pipe | 0.26 | | 176.66 | 186.46 |
| **19** | | **Manufacture of other fabricated metal product** | **11.71** | **100** | **107.78** | **111.53** |
| | 4124 | Iron rod & billets | 5.54 | | 110.96 | 110.46 |
| | 4127 | GI pipe | 6.17 | 100 | 104.93 | 112.49 |
| **20** | | **Manufacture of casting of metals** | **0.86** | **100** | **89.04** | **115.51** |
| | 4291 | Domestic metal product | 0.31 | 100 | 97.48 | 84.39 |
| | 4153 | aluminum products | 0.55 | | 84.28 | 133.05 |
| **21** | | **Manufacture of other fabricated metal product** | **7.17** | | **101.91** | **110.69** |
| | 4219 | Structural metal Product | 7.17 | | 101.91 | 110.69 |
| **22** | | **Manufacture of wire & cable** | **1.74** | **100** | **102.84** | **138.31** |
| | 4651 | Electrical wire & cable | 1.74 | | 102.84 | 138.31 |
| **23** | | **Manufacture of Furniture Manufacture** | **0.56** | | **99.98** | **104.37** |
| | 3814 | Furniture | 0.56 | | 99.98 | 104.37 |
| | | **Total Index** | 100 | 100 | **102.6** | **105.4** |

Source: Ministry of Finance.2012. Economic Survey Fiscal Year 2011/12

## 3.3.2 Industrial Policy

### 3.3.2.1 Industrial Policy 2010

As a national policy to promote development of the industrial sector, Industrial Policy 2010 has been formulated. As already described, the Policy covers broad sectors excluding commerce. Note that the policy is positioned as a general guideline for industrial development and implementation of programs set forth in it is conditioned to the approval of a new Industrial Enterprises Act by the national assembly, which substitutes for the currently effective Industrial Enterprises Act of 1992[18]. Although relevant organizations have instituted some measures at their own initiative, they basically continue existing measures which had been conducted before the formulation of the Policy.

(1) Major Component of Industrial Policy 2010

(1) Background, efforts in the past and present status
(2) Vision
(3) Objectives
(4) Policies
  1) General
  2) Special provisions relating to micro enterprises, cottage and small industries
(5) Strategies
  1) General
  2) Special policy provisions relating to micro enterprises, cottage and small industries
(6) Definition and classification of industrial enterprises
(7) Prioritized Industries
(8) Facilities and Concessions
  1) General
  2) Special provisions relating to micro enterprises, cottage and small industries
  3) Special provisions relating to Special Economic Zone
(9) Institutional Arrangement
  1) Board of Investment
  2) Industry Promotion Board
  3) National Micro Entrepreneurship, Cottage and Small Industries Development Board and Industries Development Board
(10) Special Provisions for Woman entrepreneurs

Source: Industrial Policy 2010

The vision and objectives of Industrial Policy 2010 are set forth as follows.

[18] The new Industrial Enterprises Act has already been drafted and is waiting for parliamentary approval. Also, a draft Intellectual Policy has been prepared in line with Industrial Policy 2010 and is in the waiting list. However, they may remain un-enacted until the parliament convenes after politics stabilizes, although they might be enacted as President decrees or development orders by the cabinet. Draft acts which have to be passed to implement measures set forth in the Industrial Policy 2010 are prepared according to suggestions made in the Nepal Business Forum. Being set up aiming to promote the Private-Public Dialogue, this forum also prepares proposals on regulatory reforms and what to do about Special Economic Zones. Each of the five regions holds a forum which extends one to two months. Eight theme-specific working groups, such as those discussing tourism, foreign direct investment, and export promotion, are in the forum. Chairmen of the groups are chosen from both the public and private sectors.

(2) Objective

1) To increase export of industrial products along with growth in national income and employment through enhancement of quality and competitive industrial products and productivity;
2) To increase contribution of industrial sector in the balanced national and regional development by mobilizing local resources, raw materials, skills and means;
3) To establish industrial entrepreneurship as a sustainable and reliable sector by utilizing latest technology and environment friendly production process;
4) To create strong basis of investment having developed productive human resources and managerial capacity required for industrial development thereby establish Nepal as an attractive place for investment in the South Asian region and in the world as well by;
5) To protect industrial intellectual property rights.

To accomplish the above objectives, 10 policies and 40 strategies are listed; the latter includes establishment of Special Economic Zones, easing of labor regulation, provision of additional incentives for companies that start operation in less developed areas and Special Economic Zones as well as export-oriented companies, and establishment of One Stop Service Center to streamline procedures for incorporation, registration and business expansion. Furthermore, additional 10 policies are set for micro and small-sized enterprises and cottage enterprises, together with corresponding 23 strategies including establishment of funds to improve financial access, provision of technology, advice and monitoring service, and dissemination of the one village one product movement as a nationwide campaign. Although it can be seen that the policy lists strategies in a comprehensive way as a guideline, the number of strategies seem too many.

Table 3.3-9 shows classification of companies by size under Industrial Policy 2010. Classification is made on the basis of the value of fixed property owned, but other requirements are set for microenterprises in addition to “fixed property value of Rs.200,000 or less, except for land and buildings;” which are (1) the entrepreneur himself/herself is be engaged in management, (2) there are up to nine workers including the entrepreneur, (3) the annual financial transaction is less than two million rupees, (4) if an instrument with engine is used, the electric motor or other oil engine capacity is less than ten kilowatt, (5) an enterprise is not engaged in what requires permission, such as production of liquors, beer, cigarette, biri, or other tobacco goods or materials, and (6) an enterprise has never registered once as small, medium-sized or large enterprise. In addition, industrial enterprises that use traditional skills and technology, the instruments and machinery based on local raw materials and associated with art and culture of the country and that use electric power up to 10 kilowatts are defined as “traditional and other cottage industries.” Finally, companies that exports 51% or more of their products are defined as export-oriented industries.

Table 3.3-9 Definition of Enterprises in terms of Size in the Industrial Policy 2010

| Classification | Fix Assets |
|---|---|
| Micro Industries | Up to 200 thousand rupees (except the house or land) |
| Small Scale Industries* | Up to 50 million rupees |
| Medium Scale Industries | More than 50 million to 150 million rupees |
| Large Scale Industries | More than 150 million rupees |

Source: Industrial Policy 2010

Note that the current Industrial Enterprises Act 1992 set the threshold between small and medium-sized enterprises at 30 million rupees and that between medium and large enterprises at 100 million rupees with no specific definition about micro enterprises, and relevant organizations keep using the classification (Table 3.3-10).

Table 3.3-10 Definition of Enterprises in terms of Size in the Industrial Enterprise Act 1992

| Classification | Fix Assets |
|---|---|
| Small Scale Industries* | Less than 30 million rupees |
| Medium Scale Industries | Between 30 million and 100 million rupees |
| Large Scale Industries | More than 1000 million rupees |

Source: Industrial Policy 2010

Table 3.3-11 lists priority industries designated in Industrial Policy 2010. Basically, most areas of businesses are covered.

Table 3.3-11 Prioritized Industries

1. Industries based on agriculture and forests products
2. Construction Industries (to construct and operate)
3. Energy-oriented Industries including power generation and distribution
4. Export promotion Industries
5. Industries relating to adventure tourism along with infrastructure, village tourism, eco-tourism, golf course, polo, pony trekking, trekking, water rafting, conference tourism, religious tourism, cultural tourism, fun park construction and operation, wildlife reserves
6. Mining industries, petroleum and natural gas exploration and extraction
7. Industries producing cement and clinker using native limestone, pulp and papers, sugar, chemical fertilizers (except mixing), powder milk, medicines production, processing of solid waste and unused materials, Industries manufacturing energy-saving instruments, Industries that manufacture pollution-reducing instruments, Industries manufacturing means and instruments to be used by persons with disability, Industries manufacturing agricultural tools and machinery and industrial instruments, Industries manufacturing electric vehicles
8. Public transport enterprises, cold storage construction and operation, solid waste collection, rural information and communication technology-related services, computer software
9. Hospitals, nursing homes, veterinary hospital and clinics medical examination services, health laboratory, bioresearch laboratory, teaching and training instates to be established outside Kathmandu Valley, Pokhara Sub- Municipal Corporation areas, and Sub-Municipal Corporation and Municipality areas located in the terai districts
10. Traditional cottage Industries

Source: Industrial Policy 2010

Table 3.3-12 shows areas categorized as least developed, undeveloped, and underdeveloped. Industrial Enterprise Act 1992 also classifies areas in the same way, but there are some changes regarding which areas fall in which categories. Based on the above size classification and definition and this regional classification, incentives are set forth.

Table 3.3-12 Area Classification according to the Level of Development in the Industrial Policy 2010

| |
|---|
| Least developed Area（23）<br>Bajura、Jajarkot、Dolpa、Humla、Jumla、Kalikot、Darchula、Achham、Bajhang、Mugu、Rukhum、Salyan、Dailekh、Rolpa、Tehrathum、Doti、Khotang、Sakhuwasabha、Manang、Mustang、Solukhumbu、Taplejung、Okhaldhunga<br><br>Undeveloped Area（15）<br>Baitadi、Dadeldhura、Myagdi、Bhojpur、Ilam、Sindhuli、Panchthar、Pyuthan、Baglung、Rasuwa、Sindhupalchok、Gulmi、Parbat、Dolakha Ramechhap<br><br>Under developed Area（24）<br>Kailali、Bardiya、Kanchanpur、Palpa、Lamjung、Gorkha、Arghakhachi、Dhankuta、Surkhet、Dang、Syangja、Tanahu、Udaypur、Nuwakot、Dhading、Kavrepalanchok、Kapilvastu、Siraha、Banke、Dhanusha、Rautahat、Saptari、Sarlahi、Mahottari |

Source: Industrial Policy 2010

Incentives are mainly related to income tax and other taxes (customs duties, excise tax and value added tax) and are warranted under acts that are separately enacted. Income tax incentives include special deductions, tax reduction for designated industries, such as power generaton, mining and cement, tax reduction according to geographical area of operation, and tax reduction according to the number of employees by company size. Table 3.3-13 shows the concrete content of income tax reduction (excluding deduction items) On the other hand, incentives relating to customs duties, excise tax and value added tax include reduction of tariff rates on industrial machinery and materials, generators and transformers to 1%, and reimbursement of customs duties, excise tax and value added tax imposed on raw materials and packaging materials used for export products. Then, additional incentives are established for micro, cottage and small industries. For instance, microenterprises are exempted from all taxies including income tax, excise tax and value added tax. For companies operating in SEZs, income tax reduction, exemption of value added tax and customs duties, and exemption of local tax on up to three motor vehicles are granted.

Table 3.3-13 Industrial Policy 2010 Income Tax Reduction

| Eligible Enterprises | Rate of Reduction |
|---|---|
| Special industries except in the case of an industry that produces all types of tobacco and liquors and *kattha* industries (No conditions to be considerd special industries are prescribed) | 5% reduction |
| Industries established in the least developed areas except in the case of an industry that produces all types of tobacco and liquors and *kattha* industries | 90% reduction for the 10 years after the start of transaction |
| Industries established in the undeveloped areas except in the case of an industry that produces all types of tobacco and liquors and *kattha* industries | 80% reduction for the 10 years after the start of transaction |
| Industries established in the under developed areas except in the case of an industry that produces all types of | 70% reduction for the 10 years after the start of transaction |

| Eligible Enterprises | Rate of Reduction |
|---|---|
| tobacco and liquors and *kattha* industries | |
| Industries that produce cider and wines based on fruits having a maximum alcohol content of up to 12 percent in the least developed areas | 40% reduction for the 10 years after the start of transaction |
| Industries engaged in hydro power generation and transmission, mining extraction, producing cement by making clinker with the use of local raw materials (cement industries) and industries to explore and extract petroleum or natural gas | 90% reduction for the 10 years after the start of transaction |
| Information and communication technology industries established in Information Technology Park | 50% reduction for the 10 years after the start of transaction |
| Any small-scale industry that provides a direct employment to more than 100 native workers regularly for a period of more than six months in the minimum, medium scale industries that employ more than 200 workers and large scale industris that employ more than 500 workers | 25% reduction for the year when the condition is met |
| Industry allocating 50 percent of such direct employment to native women, persons belonging to Dalit or persons with disability, | 40% reduction for the year when the condition is met |

Source: Industrial Policy 2010

Also, Industrial Policy 2010 proposes establishment of special boards: Investment Board responsible for formulation of investment policy and investment promotion; and Industrial Promotion Board to coordinate and facilitate for solution of problems facing the industrial sector. Furthermore, it sets forth establishment of National Micro Entrepreneurship, Cottage and Small Industries Promotion Board to promote micro and small-sized enterprises and eliminate non-clarity relating to administration for them. At the same time, it stipulates integrating the Department of Cottage and Small Industries into Department of Industry, while the Cottage and Small Industries Development Board will be responsible for development of micro and small scale industries in all districts. Furthermore, reinforcement and consolidation of related organizations and establishment of One Stop Service Center are to be implemented.

#### 3.3.2.2 Government Policy concerning the Industrial Sector

In the previous sections, a general outline of Industry Policy 2010 has been presented. At present, industrial development programs that are actually implemented, except for tax return, are mainly composed of training, small loans, and incubation support. Table 3.3-14 shows an excerpt from the MoI's budget. Training programs are mainly carried out by district offices of DoCSI and CSIDB as well as the Cottage and Small Scale Industry Training Centre, and their operation budgets in 2011/12 amounted to Rs.35.2 million, Rs.32.843 million, and Rs.4.97 million, respectively. Note that Micro Enterprise Development Program (MEDP) conducted under the UNDP's assistance is financed by a different budget. The following lists major industrial development measures that are currently implemented by the MoI.

Table 3.3-14 Recurrent Budget of the Ministry of Industry (Excerpt)

(1,000 Rupees)

| | Actual Expenditure 2009/10 | Revised Estimates 2010/11 | Total Budget 2011/12 | 2011/12 (Breakdown) | |
|---|---|---|---|---|---|
| | | | | GoN | Grant |
| Ministry of Industry (TOTAL) | 1,270,874 | 1,759,387 | 2,315,714 | 2,025,714 | 290,000 |
| Recurrent | 898,826 | 905,481 | 1,104,917 | 814,917 | 290,000 |
| *Program Expenses* | 400,494 | 319,076 | 519,419 | 229,421 | 290,000 |
| Capital | 372,048 | 853,906 | 1,210,797 | 1,210,797 | 0 |
| Department of Industry | 18,334 | 20,673 | 25,304 | 25,304 | |
| Recurrent | 17,775 | 19,585 | 20,986 | 20,986 | |
| *Program Expenses* | *2,451* | *3,225* | *3,225* | *3,225* | |
| Capital | 559 | 1,088 | 4,318 | 4,318 | |
| Department of Cottage & Small Industry | 24,148 | 30,365 | 31,190 | 31,190 | |
| Recurrent | 23,702 | 29,274 | 31,010 | 31,010 | |
| *Program Expenses* | *8,700* | *8,706* | *8,706* | *8,706* | |
| Capital | 446 | 1,091 | 180 | 180 | |
| Cottage and Small Industry Development Promotion Programme (27 districts) | 99,060 | 150,134 | 111,817 | 111,817 | |
| Recurrent | 96,710 | 141,750 | 100,582 | 100,582 | |
| *Program Expenses* | *41,588* | *33,322* | *35,200* | *35,200* | |
| Capital | 2,350 | 8,384 | 11,235 | 11,235 | |
| Small and Cottage Industry Promotion Program (Board) | 38,974 | 45,714 | 45,176 | 45,176 | |
| Recurrent | 35,509 | 41,338 | 42,326 | 42,326 | |
| *Program Expenses* | *8,067* | *9,225* | *11,075* | *11,075* | |
| Capital | 3,465 | 4,376 | 2,850 | 2,850 | |
| Cottage and Small Industry Promotion Programme (48 districts) | 137,193 | 158,100 | 154,232 | 154,232 | |
| Recurrent | 119,008 | 138,100 | 132,775 | 132,775 | |
| *Program Expenses* | *31,353* | *32,777* | *32,843* | *32,843* | |
| Capital | 18,185 | 20,000 | 21,457 | 21,457 | |
| Micro Enterprise Development Program | 295,629 | 218,164 | 413,225 | 123,225 | 290,000 |
| Recurrent | 295,629 | 218,164 | 413,225 | 123,225 | 290,000 |
| *Program Expenses* | *295,629* | *218,164* | *413,225* | *123,225* | *290,000* |
| (GoN) | (34,876) | (218,164) | (123,225) | | |
| (UNDP) | (260,753) | (0) | (290,000) | | |
| Capital | 0 | 0 | 0 | 0 | |
| Industrial Enterprise Development Academy | 14,922 | 15,638 | 15,352 | 15,352 | |
| Recurrent | 14,752 | 15,609 | 15,312 | 15,312 | |
| *Program Expenses* | *1,200* | *1,858* | *2,054* | *2,054* | |
| Capital | 170 | 29 | 40 | 40 | |
| Cottage and Small Scale Industry Training Centre | 17,491 | 18,832 | 25,682 | 25,682 | |
| Recurrent | 17,391 | 18,783 | 20,132 | 20,132 | |
| *Program Expenses* | *4,774* | *4,716* | *4,965* | *4,965* | |
| Capital | 100 | 49 | 5,550 | 5,550 | |

Source: Ministry of Finance. Red Book

(1) Training

District offices of DoCSI and CSIDB implement the following two training programs for the poor, entrepreneurs, and cottage and small industries: Micro-Enterprise Development for

Poverty Alleviation (MEDPA), and Micro, Cottage and Small Industries Development Program. MEDPA adopts a method used in the UNDP's Micro Enterprise Development Program and aims to allow people living below the poverty line to earn cash income by starting their own businesses. District office staff conducts survey of local resources and needs and identify target areas. Women are often selected as program recipients as many of them stay home and do not have opportunity to go to a larger town for work as men do. At present, the program is implemented in 45 out of 75 districts (20 under DoCSI's jurisdiction and 25 under CSIDB's jurisdiction) and is planned to be extended to the remaining districts. On the other hand, Micro, Cottage and Small Industries Development Program is implemented in all districts for a long period of time and accepts every applicant without prequalification.

The government allocates more or less the same amount of operational budget to each district office. As a result, around 200 persons receive training annually in districts under DoCSI's jurisdiction and around 100 persons do under CSIDB's jurisdiction. In 2010/11, a total of 13,149 in 75 districts participated in the training program.

The both training programs relating to manufacturing are designed in consideration of local resources, including agricultural products (vegetables and fruits), farm animals (milk and fur), and forest resources (wood, bamboo and herbs). Courses in the service sector include house wiring, repairing, and haircutting. According to the interviews with district offices, training courses in the management field, such as accounting and marketing, are offered, but the programs emphasize the teaching of actual production and work skills. Instructors are hired from outside. In addition, as CSIDB has around 250 staff members specialized in various fields, they also teach some courses. Although they provide consulting service for people who have started business, they cannot always meet the needs due to insufficient knowledge and skills. Also, some district offices under DoCSI's jurisdiction indicate that they do not have enough manpower due to budget constraints. People who have participated in the training program are expected to start their own businesses by using learned knowledge and skills (or use them in their existing businesses). According to CSIDB, their primary target is the local market partly because (1) production is usually small, (2) business operators need to earn cash income, and (3) many of them have no time or means to transport and sell their products in other areas. Although these programs are designed to use locally available resources, coordination with the One Village One Product movement has not been made so far.

In addition to the above two programs, the Cottage and Small Scale Industry Training Centre in Kathmandu offers training courses and 943 persons participated in 2011/12 (Table 3.3-15). Note that "Skill development training" covers all training items other than those indicated in other courses.

Table 3.3-15 Trainings held at the Cottage and Small Scale Industry Training Centre (2011/12)

| Training Courses | Number of participants |
| --- | --- |
| Skill Development Training | 557 |
| Entrepreneurship Development | 43 |
| Handmade paper | 48 |
| Leather goods | 54 |
| Readymade tailoring | 201 |
| Ceramics | 40 |
| Total | 943 |

Source: Interview with the Cottage and Small Scale Industry Training Centre

The training courses range between a few weeks and three months. Participants are recruited by newspaper ads. They are provided with free of charge. When the number of applicants exceeds the course's seating capacity, they are selected on the basis of an interview or a written examination to check basic knowledge relating to the course[19], while priority is given to women and the poor. Training courses are determined according to the actual needs and availability of instructors. The skill development training courses are often taught by outside instructors[20]. The entrepreneurship development course teaches a broad range of business knowledge and skills, including business planning, marketing, and accounting, and is very popular. However, it is conducted in a limited number of times partly because skill development is given of priority and there is a budget constraint.

DoCSI conducts various surveys to verify effectiveness of the training programs (Tables 3.3-16 and 3.3-17). The survey conducted in Kathmandu, Bara, and Mohottari found that 183 out of 704 persons who participated in the 2010/11 training program started their own businesses and 83 found paid work (37.8% of the total). Another survey traced program participants in 23 districts and revealed the employment rate of 40.38%. Analysis of the survey results indicates that there is strong demand among women for training in the fields useful for housekeeping tasks, whereas people who participated in skill training courses such as sewing, embroidering, knitting, making of pickles, jams and potato chips rarely used their learned skills to earn income. These findings suggest that it is difficult to conduct training courses that meet the actual needs of people and help them to earn cash income, not to mention the fact that skill training alone is not sufficient to empower people to start their own business or find a job.

[19] The written examination does not ask technical knowledge or skills. Instead, it seeks to check background knowledge relating to a specific course. For instance, a written examination to select participants in the cellular phone repair course asks applicants about basic knowledge on cellular phones, such as their use and type.

[20] The centre retains around 15-16 instructors in a variety of fields including sewing, food processing, leather products, engraving, and entrepreneurship.

Table 3.3-16 Result of the Trainings in 2010/2011 (1)

| Districts | Sample of Woman Trainee | Sample of Men trainee | Total | Number of training Studied | Number of Enterprise Established by The training Graduates | Number of training graduates working as wage worker | Total person employed |
|---|---|---|---|---|---|---|---|
| Kathmandu | 313 | 201 | 514 | 31 | 123 | 54 | 177 |
| Bara | 45 | 40 | 85 | 8 | 26 | 13 | 39 |
| Mahottari | 75 | 30 | 105 | 7 | 34 | 16 | 50 |
| **Total** | **433** | **271** | **704** | **46** | **183** | **83** | **266** |

Source: Department of Cottage and Small Scale Industry. Industrial Promotion Statistics 2011.

Table 3.3-17 Result of Trainings (2)

| S.N | District | Employed in % | S.N | District | Employed in % |
|---|---|---|---|---|---|
| 1 | Morang | 40.46 | 12 | Parsa | 50 |
| 2 | Rupandehi | 45.54 | 13 | Dhanusha | 58.81 |
| 3 | Saptari | 35.12 | 14 | Kaski | 51.2 |
| 4 | Kavre | 32.6 | 15 | Sarlahi | 75 |
| 5 | Sunsari | 55.6 | 16 | Makwanpur | 52 |
| 6 | Kailali | 25 | 17 | Palpa | 46.57 |
| 7 | Kapilvastu | 20 | 18 | Nawalparasi | 42.35 |
| 8 | Bardiya | 19.32 | 19 | Jhapa | 39.34 |
| 9 | Siraha | 33 | 20 | Bhaktapur | 37.16 |
| 10 | Rautahat | 18.3 | 21 | Kathmandu | 37.16 |
| 11 | Dang | 30.5 | 22 | Bara | 45.80 |
| 12 | Parsa | 50 | 23 | Mahottari | 37.91 |
| | | | **Average Total** | | **40.38** |

Source: Department of Cottage and Small Scale Industry. Industrial Promotion Statistics 2011.

(2) Micro Cottage and Small Industries Loan Fund

Micro Cottage and Small Industries Loan Fund is for participants of the training programs conducted by DoCSI and CSIDB, who want to start their own business. Using the source fund of Rs.50 million, the program provides unsecured loans, via the Agricultural Development Bank, for individuals (Rs.15,000 at maximum) and groups (Rs.60,000 at maximum, depending on the number of people involved)[21] at an interest rate lower than prevailing market rates. However, there are also criticisms about the program: there is no strong demand for the program because of a small loan; the repayment rate is low; and borrowers are determined on the basis of political consideration. In addition to the loan program, CSIDB provides intermediary service for business operators to introduce cooperatives that provide loans.

(3) Exhibitions and entrepreneur award

In order to help cottage and small industries to explore markets, DoCSI and CSIDB hold exhibitions at the national and district levels, which provide good marketing opportunity.

[21] Note that both the fund size and the loan limit vary among respondents; some indicated Rs.90 million as the basic fund and the loan limit of Rs.10,000.

Furthermore, each district office gives an entrepreneur award to one or few companies each year, which is entitled to participate in the exhibition with free of charge.

(4) Business incubation program

The incubator center is set up within a facility in Kathmandu, where offices of DoI, DoCSI and CSIDB are also located, and has three staff members to provide entrepreneur support service[22]. The program was launched in 2007 by providing support for five entrepreneurs. So far, 11 entrepreneurs have "graduated" from the program, i.e., they have started their own business, followed by corporate registration and sales expansion. The incubation center is currently assisting 15 entrepreneurs. Also, the incubation center keeps communication with the "graduated" entrepreneurs to follow up their business activities.

The incubation center's support ranges from the provision of an office space[23], advisory service by experts[24], intermediary service to introduce financial institutions, and momentary subsidy to purchase or lease testing equipment (if the budget permits). The center provides four lots of office space within the facility and gives consultation to entrepreneurs who do not use the office spaces by telephone or facsimile as well as by sending mentors. To this date, three out of eleven "graduated" entrepreneurs have started their own business outside the Kathmandu valley area, under the center's assistance.

The program's participants are recruited from all over the country. Selection is made by means of document review[25] and interview that are conducted by an evaluation group consisting of an incubation center staff member and three outside experts. Originally, applications were accepted for two months each year and the center received around 60 applications. Last year, it was decided to accept applications all the year round and the number of applications then increased to around 90. Last year, 26 proposals passed through document evaluation and 13 were selected for the program support.

According to the incubation center's staff, the program has so far produced fairly good results. At the same time, various issues are identified: difficulty in securing experts in a variety of fields to provide adequate advice for entrepreneurs; obstacles anticipated in relation to the nationwide deployment of the support program; difficulty to propagate recruitment information on a nationwide scale; insufficient level of understanding on the concept of business incubation not only in the general public but also among district staff members; and the high cost for recruiting program participants in remote areas because the current activity base is located only in Kathmandu.

[22] The operation cost is allocated from DoCSI's budget, with an annual amount of Rs.2 million.

[23] Users of the office spaces are required to pay actual costs and expenses, including copying and telephone.

[24] Experts (mentors) in various fields are made available to meet varying needs in technical and management aspects that arise from the startup to business expansion.

[25] An application form consists 9 pages that contain questions about a business idea to be proposed.

### 3.3.3 Issues relating to Development of the Manufacturing Sector

Nepal's manufacturing sector is facing a number of difficulties like the lack of industrial policy and efficient administrative capacity as mentioned in the Chapter 2. Especially, all the business managers interviewed in this survey mentioned that electricity shortage, political instability, and low productivity of labor force are the biggest three constraints, which cause high-cost operation to result in the lack of competence and low capacity utilization rates. In response, various companies adopt business models to take advantage of government policy, such as the drawback of import duties on the basis of the difference in tariff rates in comparison to exporting countries. In any case, the three main problems (electricity shortage, political instability, and low labor productivity) magnify each other to create heavy burdens on business operation in the country. At the same time, however, it is important to realize that business owners in Nepal manage to continue operation by mitigating the impacts of the negative factors, albeit sacrificing profits. In other words, many companies are still able to deal with the problems so far as they do not become an uncontrollable obstacle to normal business operation.

Thus, it is true that the three major problems (electricity shortage, political instability, and low labor productivity) make it difficult for the manufacturing sector, as well as other sectors, to operate their business. It is also true that they can still be overcome by innovative efforts on the management side. In this sense, major challenges for the manufacturing sector have to be analyzed by taking into account historical and social factors. In this recognition, this section tries to address major issues relating to development of the manufacturing sector from policy, technology and market development perspectives as follows.

(1) Issues relating to government policy

Entering 2013, the manufacturing sector in Nepal seems to be losing its presence further in the national economy as structural transformation from the agriculture sector to the service sectors makes its steady progress. Its GDP share has fallen to 7%, far behind the service sector (50%) and the agricultural sector (36%). A major reason lies in government policy that is inclined to advocate commercial capitalism, i.e., making profits by importing goods rather than making them within the country[26]. Also, the government's protection policy failed to promote development of the industry's ability to be self-supporting. Up until the 1980s, the country's manufacturing industry was dominated by traditional family concerns and recorded high growth at over 10% annually. However, it was not founded on a broad supplier base and thus did not contribute significantly to employment and GDP. Many of export companies relied on a business model to use the tariff differentials, which was thus sensitive to trade policies of importing countries, especially India, including tariff rates and non-tariff barriers. In Nepal, the

[26] For instance, finance is available merely for the short-term finance like trade and lacks long-term finance required for the industrial development. The distribution of Basic food and basic raw materials are controlled by the national monopolistic company and the subsidy, but it discourage the industrialization of substitution of import.

setting of tariff rates is a major political agenda, and the government fails to link tariff rates to medium- and long-term export promotion of industrial products made within the country on the basis of accurate understanding on the working of the manufacturing sector.

Furthermore, we should not oversee the fact that the industrial protection of the Nepali government does not necessarily promoted the self-reliance of the private sector. Driverforce of the industrial growth was the big corporate family business in Nepal until the 80s. At that period, industrial sector grew above 10% annually, but their perspective was meopic. Impact on the employment was minimum so that contribution to GDP was limited. Most of business model was based on the difference of duty and arbitrage so that the change of duty policy and non-tariff barriers of the counterpart, mostly caused by India. In Nepal, the set-up of the duty rate has been political issue, but it should be reconsidered. Government should understand the condition of the private sector and prepare the medium-term industrial promotion policy to coordinate the relevant other policies.

(2) Issues relating to production technology

Also, the triple problems of electricity shortage, political unrest and low labor productivity seem to create challenges for manufacturers in terms of production technology. In other words, electricity shortage requires manufacturing companies to use and operate a production system that is resilient to a high electricity cost, rather than production efficiency that leads to market competitiveness. On the other hand, political instability makes it difficult for companies to purchase production equipment – at a right time - that incorporates technology to help meet the market needs (e.g., because of a delay in import procedures). Finally, the shortage of skilled workers and younger workforce (who is expected to inherit skills) as they go overseas for work is a serious issue for the manufacturing sector if it is to pursue long-term development.

In fact, there is a high risk relating to investment in production equipment that provides market competitiveness, while no condition exists to accumulate production know-how and skills as a production organization. For instance, there are only one or two patent applications made in Nepal each year[27], suggesting the lack of technological base in the industrial sector.

To develop the manufacturing sector's technological strength, it is imperative to train skilled workers according to the actual market needs. The government's vocational training programs, which have been implemented to this date, have mostly lost their utility value in the job market, failing to provide good educational background for workers in their future career path. At the same time, a skill set taught by the government's training programs is no longer attractive or useful for companies. Furthermore, the provision of training opportunity needs to be linked to the development of manufacturing industries that serve as a prime mover, if skilled workers, technicians and engineers are to be fostered as a workforce having width and depth.

[27] `Number of registration of Patent, Design and Trademark`Department of Industry

In particular, it is strongly recommended to nurture engineering industries that have a broad set of production technologies as an industrial leader, which leads to the development of technological strength. Development of competent engineering industries accompanies the growth of a supplier base so as to create a channel of technological diffusion and bottom-up economic development.

(3) Issues relating to market development in the world

In India and China, the manufacturing sector is establishing competitiveness by taking advantage of rich natural resources and abundant labor supply, which enable cost reduction and productivity improvement through “economies of scale.” Obviously it is almost unthinkable for Nepal to compete with these countries on the same playing field. Instead, the country can focus on highly specialized strategies, namely “small-scale production system targeting niche markets,” “Development strategy through the corroboration between Japanese small and medium enterprises and Nepal regional industries,” and “integration with value chains of global corporations,” and “branding strategy.”

First of all, the manufacturing industry in Nepal should target the niche market. Because of a small size, the niche market unlikely draws attention of large companies in India or China, whereas manufacturers in Nepal – even a large one from the country’s standard (say, around 300 employees) – are capable of meeting the needs of the niche market on account of flexible production. A small lot production system is suitable and economical for foreign distributors that serve the niche market. At the same time, it allows retailers, wholesalers and importers to minimize the risk by making orders in a minimum required quantity. Furthermore, establishing good relationship with the niche market offers an additional advantage in providing opportunity to develop partnership with customers in terms of product management and technology transfer.

Secondly, it would worth considering the development strategy of corroboration between apanese small and medium enterprises and Nepal regional industries. For instance, many of Japanese fortune-teller message paper are made in Nepal. One of the biggest Japnese cosmetic manufacturing company, Kanebo used to import raw materials from Nepal. Even these days, Kaldi Coffee which supplies imported foods in Southenwest Tokyo send the staff to Nepal. Project Formulation Survey of BOP (Base of Pyramid) may encourage the business for both ends. Promotion of export from rural area of Nepal to Japnese market will commercialize the raw materials of Nepal both in scale and quality. Economy size of Nepal is so small that even Japanese small and medium enterprises’demands may be attractive for nepali counterparts.

Thirddly, integration with value chains of global corporations should be premised on the manufacturing sector’s ability to make goods with uniformly high quality and at a steady rate of output. In building up a value chain, global corporations place importance on reliability as well as cost. The manufacturing sector in Nepal cannot meet these needs because their output is fairly small and cannot be assured due to an electricity shortage or a labor dispute. As large corporations in India and China are in the process of integrating local suppliers into their value chains, manufacturers are expected to have "just-in-time" supply capability that incorporates "small lot production" at a more advanced stage than the one discussed earlier. Clearly, it is a formidable challenge for the manufacturing sector in Nepal, if it intends to become part of a global value chain.

As a first step, small production management and a variety of cross -category products for the nitch market or high quality products accommodated for the market demand in the specific foreign market will contribute to the capital accumulation and the improvement of fundamental capacity of the company. After the empowerment of capital, management and technology, it would be the time to try to proliferate the business. At that stage, the substitution of production goods and punctual and detail - oriented production management would be required. Trust for the production from the foreign market stakeholders will be gained to reach that stage. That is the right time to be recognized as a reliable partner for the global value chain integration.

Finally, branding strategy means the development of strategic industries, which will be able to constitute a major economic base when the electricity problem is ameliorated significantly. They should have an effective downstream linkage, serve as a major source of technology transfer throughout the rest of the manufacturing sector, and have high positive impacts (multiple effects) on other sectors. Their growth will be indispensable for development of the manufacturing industry from long-term perspectives. Development of strategic industries must accompany the development of flagship products that represent the country's industry. In so doing, product planners, designers, manufacturers, and marketers need to work together to maximize product power. Their experience is expected to become valuable assets, both tangible and intangible, that can be shared and used by the entire industry in the long run. For instance, the ongoing effort to develop pashmina to a global brand should be made with long-term commitment to high goals of expanding its application to other high value added textile products and establishing it as a national brand.

## 3.4 Tourism

### 3.4.1 Current State

#### 3.4.1.1 Tourism Sector

Nepal's tourism is not so large in terms of GDP share (3.2%) and employment (3.4%) in 2011[28], but it makes significant contribution to the national economy by means of close linkage to various sectors, such as commerce, transportation, and construction, and is one of the major foreign currency earners, although it faces various challenges. The current state of tourism in Nepal is summarized as follows.

(1) Yearly change and composition of foreign visitors

Table 3.4-1 presents key data relating to tourism. First of all, the number of visitors reached 736,215 in 2011, which was designated as "Nepal Tourism Year". Although fallen short of a 1 million target, the number of visitors grew at 18-22% annually in the two consecutive years of 2010 and 2011. It represents a good recovery from a significant worsening of the country's image as the internal conflicts between 2000 and 2006 were reported worldwide. In light of the fact that the number of visitors sank to 270 thousand in 2002, the lowest level in its recent history, tourism is considered to be even entering an expansion stage.

Indians represent the largest share (around 20%) of visitors, followed by Chinese and Sri Lankan (2011 data). The number of visitors from Sri Lanka surpassed that from China until 2009. A large number of visitors from India and Sri Lanka can be attributed to not only close economic ties among the three countries but also their historical and cultural relations, which lead to visits for the purpose of business or pilgrimage. (Table 3.4-2)

After the top three countries, Nepal receives visitors from the U.S., the UK, Germany, France, and Japan, who mostly come for sight-seeing. As already described, China (including Hong Kong) has recently surpassed these countries to rank second partly because entry of business persons has increased substantially and because Chinese tourists have grown in number to reflect the country's rising income. It is also the result of promotional efforts made by the Nepal government to attract Chinese tourists. From Japan, around 23,000 – 27,000 people visit Nepal a year and most of them enjoy sight-seeing. In particular, the country is popular among middle-aged and elderly people who like trekking and tours to ancient cities.

[28] Note that the percentage represents employees in the hotel and restaurant sector. According to World Travel and Tourism Council (WTTC), the total number of employees in the entire tourist industry, including related industries, is estimated at around 950,000, accounting for 7.6% of the country's total employment in 2011.

## Table 3.4-1 Summary of Tourism Statistics, 2010-2011

| Indicators | 2010 | 2011 | Change |
|---|---|---|---|
| Tourist Arrival by | | | |
| Air | 448,800 | 545,221 | 21.5% |
| Land | 154,067 | 190,994 | 24.0% |
| Total | 602,867 | 736,215 | 22.1% |
| Average Length of Stay | 12.67 | 13.12 | 3.6% |
| Top Five Country of Nationality | | | |
| Rank 1 | India | India | |
| Rank 2 | P.R. of China | P.R. of China | |
| Rank 3 | Sri Lanka | Sri Lanka | |
| Rank 4 | U.S.A. | U.S.A. | |
| Rank 5 | U.K | U.K | |
| Purpose of Visit | | | |
| Holiday Pleasure | 63,082 | 30,210 | -52.1% |
| Trekking | 66,593 | 81,948 | 23.1% |
| Mountaineering | 3,625 | 4,312 | 19.0% |
| Business | 21,377 | 17,859 | -16.5% |
| Pilgrimage | 101,335 | 63,783 | -37.1% |
| Official | 26,374 | 24,054 | -8.8% |
| Conference/Conv. | 9,627 | 10,836 | 12.6% |
| Rafting | 730 | 2,181 | 198.8% |
| Travel/Visit | 200,856 | 395,511 | 96.9% |
| Study/Research/Employment | 5,101 | 5,235 | 2.6% |
| Others | 46,516 | 29,895 | -35.7% |
| Not Specified | 57,651 | 70,391 | 22.1% |
| Revenue from Tourism | | | |
| Total Earning (US$ '000) | 396,324 | 321,456 | -18.9% |
| Average Income per Visitor per day (US$) | 43.2 | 38.2 | -11.6% |
| Registered Tourism Related Enterprises | | | |
| Hotel (Kath. Valley) | 464 | 503 | 8.4% |
| Rooms (Kath. Valley) | 9,880 | 10,752 | 8.8% |
| Beds (Kath. Valley) | 19,463 | 20,941 | 7.6% |
| Travel Agencies | 1,739 | 1,936 | 11.3% |
| Trekking Agencies | 1,240 | 1,378 | 11.1% |
| Tourist Guide | 2,661 | 2,835 | 6.5% |
| Trekking Guide | 6,747 | 7,303 | 8.2% |
| Place Visited in Nepal | | | |
| Pashupati Area (excluding Indian) | | 143,887 | |
| Lumbini (excluding Indian Tourists) | 99,508 | 128,259 | 28.9% |
| National Parks and Wildlife Reserve | 145,468 | 194,123 | 33.4% |
| Mustang Trekking | 2,162 | 2,950 | 36.4% |
| Lower Dolpa Trekking | 785 | 808 | 2.9% |
| Upper Dolpa Trekking | 358 | 397 | 10.9% |
| Humla Trekking | 1,633 | 1,758 | 7.7% |
| Manaslu Trekking | 2,162 | 2,813 | 30.1% |
| Kanchanjunga Trekking | 488 | 591 | 21.1% |
| Tourists Departure by | | | |
| Air | 499,457 | 612,922 | 22.7% |
| Land | 132,325 | 165,185 | 24.8% |
| Total | 631,782 | 778,107 | 23.2% |
| Nepaleses Outgoing | | | |
| Male | 667,512 | 668,558 | 0.2% |
| Female | 97,323 | 105,396 | 8.3% |
| Total | 764,835 | 773,954 | 1.2% |
| Nepaleses Incoming | | | |
| Male | 560,059 | 604,593 | 8.0% |
| Female | 87,226 | 97,869 | 12.2% |
| Total | 647,285 | 702,462 | 8.5% |

Source: Ministry of Culture, Tourism and Civil Aviation

Table 3.4-2 Tourist Arrival by Major Nationalities

| | 2002 | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|---|
| India | 66,777<br>24.20% | 96,010<br>18.20% | 91,177<br>18.20% | 93,884<br>18.40% | 120,898<br>20.10% | 149,504<br>20.30% |
| China | 8,715<br>3.20% | 28,618<br>5.40% | 35,166<br>7.00% | 32,272<br>6.30% | 46,360<br>7.70% | 61,917<br>8.40% |
| Sri Lanka | 9,805<br>3.60% | 49,947<br>9.50% | 37,817<br>7.60% | 36,362<br>7.10% | 45,531<br>7.60% | 59,884<br>8.10% |
| U.S.A. | 17,518<br>6.40% | 29,783<br>5.70% | 30,076<br>6.00% | 32,043<br>6.30% | 36,425<br>6.00% | 42,875<br>5.80% |
| U.K. | 21,007<br>7.60% | 32,367<br>6.10% | 33,658<br>6.70% | 35,382<br>6.90% | 35,091<br>5.80% | 39,091<br>5.30% |
| Germany | 15,774<br>5.70% | 21,323<br>4.00% | 18,552<br>3.70% | 19,246<br>3.80% | 22,583<br>3.70% | 27,472<br>3.70% |
| France | 13,376<br>4.90% | 20,250<br>3.80% | 22,402<br>4.50% | 22,154<br>4.30% | 24,550<br>4.10% | 26,720<br>3.60% |
| Japan | 23,223<br>8.40% | 27,058<br>5.10% | 23,383<br>4.70% | 22,445<br>4.40% | 23,332<br>3.90% | 26,283<br>3.60% |
| Others | 58,205<br>21.10% | 151,209<br>28.70% | 140,830<br>28.20% | 146,617<br>28.80% | 172,055<br>28.50% | 204,591<br>27.80% |
| Total | 275,468<br>100% | 526,705<br>100% | 500,277<br>100% | 509,956<br>100% | 602,867<br>100% | 736,215<br>100% |

Source: Ministry of Culture, Tourism and Civil Aviation

(2) Purpose of visit, entry route, and length of stay

Table 3.4-3 classifies visitors by purpose of visit, based on the information given in the entry format. Although many visitors just declare the purpose of visit as “travel” (a significant number of them did not fill out the entry item, too.), the government estimates that most of them are tourists. Among others, visitors for religious purpose, pilgrims visiting various sacred places, Janakpur (Hinduism) and Lumbini (birth place of Buddha) in particular, have increased significantly since 2002. They usually visit en masse within a specific period of time, but recently more visitors stay a shorter period than before. Finally, Nepal attracts a large number of tourists who enjoy traditional trekking and mountaineering activities in the Himalaya Mountains.

Table 3.4-4 classifies visitors by entry route and the average length of stay. Most visitors come by air, which reflects that air transport is the best access for tourists coming from China, the U.S., Europe and Japan to the inland company. Some visitors come from India, usually by bus; they are pilgrims from India and Sri Lanka, who visit the four major Buddhist holy places in India and Nepal[29]. Note that Indians can generally enter Nepal without visa and those who visit Nepal for trade or works are not included in the above statistics, which include Indian tourists and pilgrims visiting Janakpur.

[29] The four Buddhist holy places are, in addition to Lumbini, Bodh Gaya (Bihar, India), Sarnath (Uttar Pradesh, India), and Kushinagar.

The average length of stay for all visitors is slightly less than two weeks, reflecting the fact that many of them briefly stay in Kathmandu and visit other areas for trekking and sightseeing. Note that, other than Kathmandu, the largest number of tourists visit Bhaktapur (54%), followed by Pokhara (52%) and Lalitpur (48%).

Table 3.4-3 Tourist Arrival by Purpose of Visit

| Year | Holiday Pleasure | Trekking & Mountaineering | Business | Pilgrimage | Others | Total |
|---|---|---|---|---|---|---|
| 1992 | 237,711 | 35,166 | 31,765 | 7,219 | 22,492 | 334,353 |
| | 71.1% | 10.5% | 9.5% | 2.2% | 6.7% | 100.0% |
| 1997 | 249,360 | 91,525 | 27,409 | 4,068 | 49,495 | 421,857 |
| | 59.1% | 21.7% | 6.5% | 1.0% | 11.7% | 100.0% |
| 2002 | 110,143 | 59,279 | 16,990 | 12,366 | 76,690 | 275,468 |
| | 40.0% | 21.5% | 6.2% | 4.5% | 27.8% | 100.0% |
| 2007 | 217,815 | 101,320 | 24,487 | 52,594 | 130,489 | 526,705 |
| | 41.4% | 19.2% | 4.6% | 10.0% | 24.8% | 100.0% |
| 2008 | 148,180 | 104,822 | 23,039 | 45,091 | 179,145 | 500,277 |
| | 29.6% | 21.0% | 4.6% | 9.0% | 35.8% | 100.0% |
| 2009 | 40,992 | 132,929 | 22,758 | 51,542 | 261,735 | 509,956 |
| | 8.0% | 26.1% | 4.5% | 10.1% | 51.3% | 100.0% |
| 2010 | 63,082 | 70,218 | 21,377 | 101,335 | 346,855 | 602,867 |
| | 10.5% | 11.6% | 3.5% | 16.8% | 57.5% | 100.0% |
| 2011 | 30,210 | 86,260 | 17,859 | 63,783 | 538,103 | 736,215 |
| | 4.1% | 11.7% | 2.4% | 8.7% | 73.1% | 100.0% |

Source: Ministry of Culture, Tourism and Civil Aviation

Table 3.4-4 Tourist Arrival and Average Length of Stay

| Year | Total | | By Air | | By Land | | Average Length of Stay |
|---|---|---|---|---|---|---|---|
| | Number | Annual Growth Rate (%) | Number | Percent | Number | Percent | |
| 1992 | 334,353 | 14.1 | 300,496 | 89.9% | 33,857 | 10.1% | 10.14 |
| 1997 | 421,857 | 7.2 | 371,145 | 88.0% | 50,712 | 12.0% | 10.49 |
| 2002 | 275,468 | -23.7 | 218,660 | 79.4% | 56,808 | 20.6% | 7.92 |
| 2007 | 526,705 | 37.2 | 360,713 | 68.5% | 165,992 | 31.5% | 11.96 |
| 2008 | 500,277 | -5.0 | 374,661 | 74.9% | 125,616 | 25.1% | 11.78 |
| 2009 | 509,956 | 1.9 | 379,322 | 74.4% | 130,634 | 25.6% | 11.32 |
| 2010 | 602,867 | 18.2 | 448,800 | 74.4% | 154,067 | 25.6% | 12.67 |
| 2011 | 736,215 | 22.1 | 545,221 | 74.1% | 190,994 | 25.9% | 13.12 |

Source: Ministry of Culture, Tourism and Civil Aviation

(3) Tourism revenue

The tourism in Nepal serves as an important source of foreign currency revenue, amounting to \$300 – 400 million in recent years (Table 3.4-5). This is equivalent to as much as 44% of the country’s total exports in 2010. However, detailed analysis indicates that the tourism revenue has not been increasing at the pace of the increase in foreign visitors in recent years. That is, each visitor spends less and less in the country. As shown in Table 3.4-1, sales per person per day decreased from \$43.2 in 2010 to \$38.2 in 2011. According to the analysis of the National Tourism Board (NTB), as the average length of stay has not changed significantly, the recent decline in tourism revenue can be attributed to an increasing number of cases that tourists pay tour fares and fees in their own countries. Other factors are the decrease in the length of stay by pilgrims and an increasing thrifty attitude of tourists in the wake of the worldwide bleak economic conditions.

Table 3.4-5 Gross Foreign Exchange Earnings from Tourism by Fiscal year

| | Total Earnings | | % Change in US$ |
|---|---|---|---|
| | Nrs. (000) | US$ (000) | |
| 1997 | 6,158,800 | 108,527 | -8.8 |
| 2002 | 7,798,535 | 101,628 | -37.5 |
| 2007 | 12,645,761 | 181,243 | 11.8 |
| 2008 | 20,339,890 | 313,941 | 73.2 |
| 2009 | 27,959,800 | 359,011 | 14.4 |
| 2010 | 28,139,000 | 396,324 | 10.4 |
| 2011 | 23,948,480 | 321,456 | -18.9 |

Source: Nepal Rastra Bank

(4) Hotel occupancy rate

In Nepal, there are around 500 hotels that can accommodate foreign visitors (equivalent to around 20,000 beds), together with around 80 home stay type accommodation facilities (300 beds). While the number of hotels seems to be rather small for the tourist country, it reflects the tendency that demand is unevenly high during the dry season when weather is good and Mount Everest and other mountains are clearly visible. Table 3.4-6 shows monthly occupancy rates of five-star hotels in 2011. In comparison to the total availability of 54,000 rooms per month, occupancy rates of over 60% occur in February through April and in October and November. The situation seems to be same for home stay type hotels. In particular, facilities in the mountain area enter the off-season for some periods of time. A major challenge for the country’s hotel and tourism industries is to attract tourists during the off-peak seasons.

Table 3.4-6 Room Occupancy Rate by Month for Five Star Hotel in Nepal, 2011

| Month | Rooms | | Occupancy Rate |
|---|---|---|---|
| | Available | Occupied | |
| January | 54,498 | 26,504 | 48.63% |
| February | 49,224 | 30,702 | 62.37% |
| March | 54,498 | 34,301 | 62.94% |
| April | 52,740 | 35,723 | 67.73% |
| May | 54,498 | 32,120 | 58.94% |
| June | 52,740 | 29,593 | 56.11% |
| July | 54,498 | 25,927 | 47.57% |
| August | 54,498 | 31,105 | 57.08% |
| September | 52,740 | 29,632 | 56.19% |
| October | 54,498 | 42,197 | 77.43% |
| November | 52,740 | 45,337 | 85.96% |
| December | 54,498 | 32,318 | 59.30% |
| Total | 641,670 | 395,459 | 61.63% |

Source: Ministry of Culture, Tourism and Civil Aviation

### 3.4.1.2 Information and Telecommunication Industries

(1) Telecommunication industry

In Nepal, around 150 ICT related enterprises are registered. It is estimated that arounc 300 enterprises and 2,500 to 3,00 workers are in the ICT sector, if informal ones are included. No statistical data presenting the GDP share of this sector is available. Given that the sector was formed after 2000, it should be still a small one. No hardware enterprises (for example, enterprises producing personal computers) are in Nepal. Three to four large companies are competing in the telecommunication business.

Nepal’s telecommunication policy (Telecommunication Policy 1999) is to encourage private companies to participate and compete in every field of telecommunication service under regulation and supervision of Nepal Telecommunication Authority (NTA). Table 3.4-7 summarizes types of telecommunication service licenses and companies to which the license has been issued (as of the end of 2011). Note that NDCL was a former state enterprise and is currently in the process of privatization.

Table 3.4-7 Licensed Companies (as of Dec. 2011)

| Licenses | Providers |
|---|---|
| Normal Telecommunication Service | - Nepal Doorsanchar Co., Ltd (NDCL)<br>- United Telecom Limited (UTL)<br>- Nepal Satellite Telecom Pvt.,Ltd(NSTPL) |
| Mobile Telecommunication Service | - Nepal Doorsanchar Co., Ltd (NDCL)<br>- Ncell Pvt., Ltd (Ncell) |
| Telecommunication Service in Rural area | - STM Telecom Sanchar Pvt., Ltd<br>- Smart Telecom Pvt., Ltd |
| Others | - Limited Mobility (105), VSAT (100), ISP (49) |

Source: Nepal Telecommunication Authority

Similarly, the government announced IT policy 2010 in May 2010, which sets forth specific policies and programs for promotion of the IC industry by expanding outsourcing service using IT, including the establishment of a unit responsible for promotion of foreign direct investment in the IT sector and the development of systems and institutions relating to electronic commerce.

Table 3.4-8 summarizes the propagation of telecommunication services in Nepal. Notably, the ownership rate of fixed-line phones is very low while mobile phone service grows rapidly to attract most of new users. At the same time, Internet users are on the rapid rise since 2009. Nepal introduced the Internet service in 1999 but market acceptance was very slow partly due to strict regulations. After the democratization in 2006, however, socioeconomic changes have resulted in a steady increase in the number of ISP operators. Today, broadband service users are estimated at around 3,280,000 persons (as of 2012). NDCL started Wi-Fi service in January 2012. International telecommunication service is provided via Intelsat satellites.

Table 3.4-8 Penetration rate by telecommunication

| | | |
|---|---|---|
| Wire line | No. of lines 850,000 lines | Penetration rate 3.2% |
| Mobile | Subscribers 13.3 millions | Penetration rate 50.2% |
| Internet | Users more than 4 millions | BB users 3.28 millions (Penetration rate: 20.9%) |

Source: ITU Statistics

(2) ICT companies

In Nepal, there are 150-180 companies engaged in information and communication business on the basis of membership data on related trade associations. In addition, there are a sizable number of informal business operators, making a grand total of around 300 companies. Of total, there is only one hardware manufacturer that is engaged in assembly of UPS, whereas other hardware companies primarily import and market foreign products. On the other hand, software companies are engaged in call center service, animation production (subcontracting), and GIC-related work, Web site design and development of applications for cell phones. The largest company is a call center operated by a U.S. company and hires nearly 500 persons. Other companies of relatively large size have 30 – 50 employees. Three Japanese companies hire Nepalese software companies to develop software products on a contract basis. Thus, Nepal’s software industry has potential to grow by leveraging outsourcing contracts with foreign companies.

A major issue facing Nepal’s software industry is the absence of industrial standards. In response, a local company, Professional Computer Service, takes a lead in promoting ISO and makes steady progress toward the establishment of de-facto industrial standards. Another problem is the shortage of senior software engineers and IT professionals. In Nepal, around 3,000 persons per year have completed advanced IT education in the recent few years, but it takes some more time to have a sufficient number of experienced engineers and many are sent by foreign customers who do outsourcing or are hired from India. At the same time, Nepal's IT industry is not widely recognized in other countries and does not make much promotion to let it be known to potential markets. The industry is asking the government for financial and other support in this regard but has not obtained sufficient support due to the difficulty in government finance.

Nepal imposed no or very low (1%) import tariff on PCs and other ICT related products, and 60% of VAT is reimbursed for cell phones. IT engineers and workers have relatively high English language skills and their wages are 30% lower than those in India. There is an IT park in Banepa, a suburb of Kathmandu, which was developed ten years ago and offers good infrastructure, including ample space, attractive to IT companies. Thus, Nepal's IT industry has high potential to grow around Banepa.

### 3.4.2 Tourism Promotion Policy

(1) Past trend

Tourism has been consistently taken up in the national development plans as one of the key industries capable of using the country's natural resources and thereby earning foreign currency. Even so, a major change in the form of tourism development occurred in 1990 after the country's transition to democracy. As discussed in the section on national economic development, the country's five-year development plans traditionally set the two major goals of elimination of regional inequality and reduction of poverty through rural development. In accordance with them, with the help of international and donor organizations, the government in the 1970s and 1980s formulated master plans for tourism development, explored and preserved scenic spots and ancient cities, and constructed tourist service facilities such as hotels and minimum-required infrastructure in areas other than Kathmandu. These activities aimed to build a new foundation for mass tourism that allows ordinary tourists to enjoy the nature and historical sites unique to Nepal by changing the country's image as a special place for mountain-climing and expeditions of unexplored regions which had been prevalent since the successful conquering of Mount Everest by Sir Edmund Hillary in 1953. In 1986, the country also started the Annapuma Conservation Area Project, a prototype of eco tourism, to develop tourist resources in and around Pokhara.

Notably, tourism development until the 1980's was primarily undertaken by local capital, although it received some assistance and support from international donor organizations. Then, foreign investment started to increase after the enactment of the Foreign Investment Act in 1994, which permits 100% foreign capital injection for projects worth $10 million or more as well as remittance of profits to host countries[30]. Two U.S. five-star hotel chains – Hotel Radisson and Hyatt International –built hotels in Kathmandu and started operateation in 1998. Also, a large number of travel agents operated by foreigners (although majority owned by local investors) have emerged to provide service for foreign tourists. In 1998, the tourist industry, together with the government, carried out an international campaign, designating the year as the Visit Nepal Year and around 460,000 visitors were recorded (a further increase to 490,000 in 1999).

In the 1990s, Nepal's tourism enjoyed significant growth in terms of the number of visitors and foreign currency revenue by taking advantage of liberalization of business and improved service quality as a result of increased competition. From 2000 to 2006-07, however, the number of tourists plummeted due to the aforementioned internal conflict, which ruined the international promotional efforts led by Visit Nepal Year 1998 campaign and thus severely damaged the entire industry. After the regaining of peace and security, the government developed Tourism Policy 2008 with an aim to promote sustainable tourism development as an engine for economic growth and job creation. It should be noted that the new policy emphasizes tourism development for not only attraction of foreign tourists but also local tourists. Then the Nepal Tourism Year 2011 campaign was carried out inside and outside the country, and the number of foreign tourists increased to 740 thousand in 2011. Furthermore, the government has announced "Vision 2020," under which the country is divided into 18 tourism zones, including the Farwest region where tourism development is lagged behind, to promote tourism development by taking advantage of resources available in each zone, although specific actions have yet to be taken to put the vision into reality.

(2) Tourism Policy 2008

Tourism Policy 2008 has been formulated to promote further expansion of tourism under the new government. Developed under the leadership of the Ministry of Tourism and Civil Aviation, it continues to serve as a policy guideline for tourism development in the country for three years since its announcement. Various programs including the Nepal Tourism Year 2011 are implemented under the government's budget.

Tourism Policy 2008 sets forth long-term visions and goals for tourism development on the basis of analysis of the current state of the industry. To achieve the goals, it establishes the following specific development policies.

1) To formulate a master plan for tourism development from perspectives of regional development, which consists of period-specific and annual plans.

[30] Later, foreign equity participation in tourism, including hotels, has been limited to 80%, and foreign companies are now required to form a joint venture with local partners.

2) To promote rural tourism by encouraging participating of women and ethnic groups, who have not previously involved in the tourism development process, to form an integral part of the future industry.
3) To promote tourism by local people.
4) To position and foster tourism as a key service sector, regardless of companies involved.
5) To encourage public and private partnership in tourism development projects undertaken by large enterprises, including participation of small- and medium-sized enterprises, and to use a BOT (build, operate, and transfer) model for development of tourism infrastructure.
6) To promote the aviation industry that that reaches the industrial levels in terms of safety, punctuality, and reliability.
7) To encourage the leadership role and investment of the private sector in tourism and its development.
8) To promote human resource development, cooperation and interaction among related sectors, and effective analysis and utilization of data for the purpose of improving tourism service in terms of both quality and quantity.
9) To development tourism infrastructure with an emphasis on environmental preservation as the highest priority.
10) To use latest information technology for marketing activity relating to tourism.
11) To take effective measures to ensure safety of tourists visiting the country.
12) To use available support tools for the purpose of developing tourism as the country's key industry.
13) To ensure good labor relations within the tourist industry.
14) To revise and update laws and legal procedures relating to tourism development.
15) To reinforce cooperation among ministries and departments relating to infrastructure development.
16) To establish the Tourism Council and the Tourism Development Coordination Committee organized by representatives of related ministries and departments in order to ensure smooth and coordinated implementation of the new tourism policy.

To implement these diverse policies, Tourism Policy 2008 sets forth a wide range of action plans. While the ideas behind them are not entirely new, they seem to clearly define desirable roles of all parties relating to tourism together with a desirable direction of tourism development. In particular, a major focus of action plans is placed on expansion of a range of activities available for tourists, from traditional mountaineering, trekking, cultural experience, and religious tourism to rafting and other sports, cinema, education, health, and agro-tourism. A problem lies in a recent tendency that government budgeting is delayed due to political unrest, which may prevent action plans from being implemented in a consistent and timely manner. As a result, investment under private initiative needs to be much relied upon.

### 3.4.3 Current State of Tourism Development and Major Issues

As pointed out earlier, the number of visitors exceeded 740,000 in 2011 and the government hopes to achieve a million marks in 2012 under the slogan "Nepal Tourism Year: Lumbini 2012." According to the statistics between January and August, the number of visitors reached around 500,000, and it is expected to approach one million if the tourist season in October and November goes well as in the normal year. The recent growth suggests high growth potential of Nepal's tourism although effective development efforts have to be taken to materialize growth.

According to opinions and views obtained from interviews conducted in Kathmandu and other cities including Pokhara, major issues relating to further development of tourism in Nepal can be summarized as follows.

(1) Absence of coordinators in the field of comprehensive tourism development

As discussed earlier, Nepal's tourism is fairly diverse and involves a wide variety of service providers. At the same time, service facilities are fairly small, except for a limited number of large hotels. As small facilities and operators, including hotels, restaurants, transportation service, guides (mountains and safari), travel agencies, and souvenir shops, work independently in each tourist area, there is an apparent lack of coordinated efforts to generate and maintain synergies among them. Although the government has announced Vision 2020 as a policy guideline to develop tourism as a major industry, there are no personnel in the private sector who can act as a coordinator to supervise and manage a variety of actions needed to achieve the goal. Meanwhile, the government has still to offer specific incentives for the private sector to take initiatives for comprehensive tourism development. The government made some efforts during the campaign for the 2011 Tourism Year, but they failed to activate private initiatives. As a result, promotional activities by the entire tourist industry are fading after the end of the year. To reinvigorate development efforts, leaders and coordinators for appropriate actions are necessary from both the private and public sectors.

(2) Need for development of airports and air routes

At present, 76% of visitors come to Nepal by air because of its landlocked location. There are many commercial airports to serve vast mountainous land, but there is only one international airport in Kathmandu. Furthermore, Kathmandu Airport is considered to be costly for airlines in terms of landing and parking fees and land operation costs in comparison to international standards, and some airlines including Lufthansa and Singapore Airlines have ceased to use the airport, followed by Gulf Air, which announced to terminate service on March 25, 2013. Clearly, it is the time to develop ideas and incentives to attract foreign airlines to Nepal so that more foreign tourists come to Nepal. In light of the fact that majority of foreign tourists visit the Pokhara area, it is worth considering the construction of an international airport in Pokhara (some preliminary action is being taken). Meanwhile, Nepal Airlines (NAC), the national flag carrier, is unable to purchase new airplanes or explore new flight routes due to management problems. As improvement of NAC's service is a key to further development of the entire tourist industry, efforts should be made to improve its management, including considering subscription of foreign capital.

(3) Need for improvement of land routes with India and China

As discussed earlier, India and China ranked the first and second in the number of visitors in 2011. Thus, improving land routes with these countries (together with Sri Lanka, which ranked third) is expected to help draw more tourists. Also, as Nepal has a large number of tourist attractions along the borders with India and China, improved land access can pave the way for developing new sightseeing opportunities in combination with tours in India or China, which can attract tourists from the U.S. and Europe. In addition to tourism, improvement of transportation access which could be mass transit to India and China is expected to become a boon to the national economy, although consideration should be given to the possible impacts on the country's political relationship with the two countries.

(4) Need for development of diverse tourist attractions and deregulation relating to mountaineering and trekking

At present, the Nepali government tries to develop new tourist attractions focusing on sports and health, while expanding tourism development efforts throughout the country. While these approaches can be very effective in attracting more visitors by offering new ways of enjoying the country and its nature, efforts should be made to increase the number of visitors who come to Nepal repeatedly, especially those who enjoy mountaineering and trekking. In Nepal, there are over 1,300 mountains that are 3,000 meters or higher, but only 326 mountains are open to visitors. Making more mountains accessible to climbers and trekkers would help lead to much-desired diversification of tourism in the country. Also, agro tourism combined with trekking as well as adventure tourism making use of topography like valleys and mountains is likely to attract foreign tourists.

(5) Need for more vigorous promotional campaigns using international media

Despite the rapid growth of visitors to nearly 740,000 in 2011, Nepal ranked fourth in South Asia, after India, the Maldives, and Sri Lanka. In particular, Sri Lanka also experienced a sharp decline in the number of visitors due to the eruption of internal conflict that threated security and stability during the same period when Nepal had political unrest. The problems were significantly improved in the both countries after 2007, followed by the comeback of visitors. In response, Sri Lanka moved quickly to launch aggressive promotion to attract foreign tourists by using mass media in the West and Japan. As a result, the number of visitors grew to around 850,000 in 2011, far exceeding that of Nepal. As the difference seems to come partly from rather limited promotional campaigns by Nepal in terms of scale and range, it is important for the Nepali government to step up promotional efforts to reach a wider potential market in a more effective manner.

In conclusion, tourism in Nepal has great potential to further growth by improving tourism infrastructure in terms of both hard and soft aspects and by sending a clear message to the world that it is endowed with attractive nature and there are diverse ways of enjoying stay, not to mention good security and safety for visitors.

## 3.5 Financial Sector

### 3.5.1 General Background

(1) Number of financial institutions

Nepal's financial sector has been rapidly growing in recent years. Domestic loans extended to the private sector, as percentage of GDP, increased from 28% in 2005 to 56% in 2010, indicating substantial growth of the financial market in width and depth[31]. Also, the loan/deposit ratio rose to over 73% in 2010, and if foreign currency deposits are not included, the ratio reached 82%. The financial sector in Nepal is composed of three types of organizations: financial institutions licensed and regulated by the central bank (Nepal Rastra Bank)[32], those licensed and regulated by the MoF, and other informal financial institutions (Figure 3.5-1).

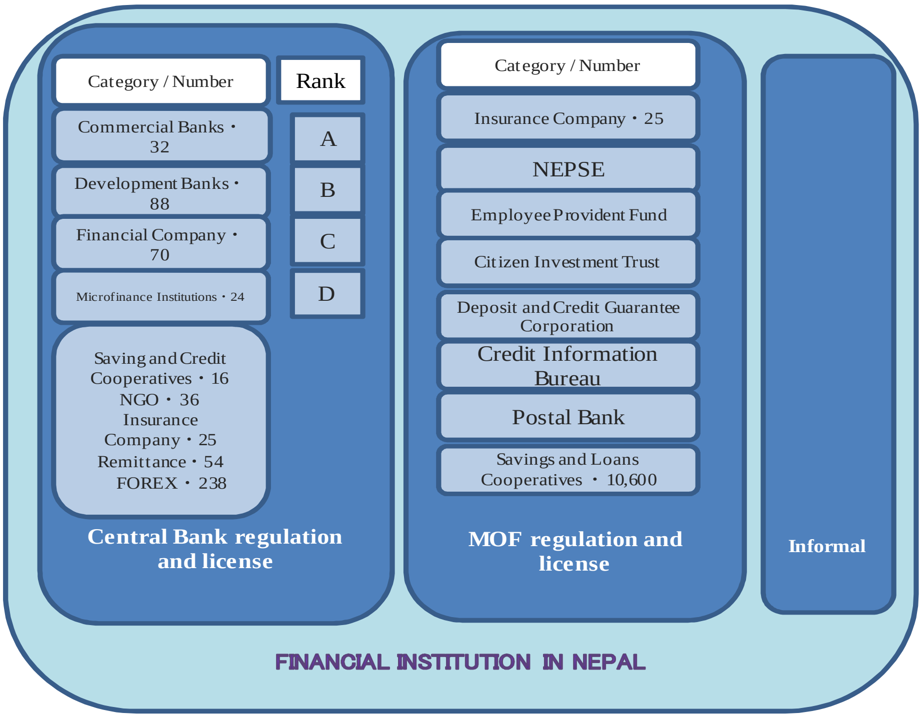



Figure 3.5-1 Financial Institutions in Nepal

In addition to the above financial institutions, the following organizations are licensed and regulated by the MoF: 25 insurance companies, Nepal Stock Exchange (NEPSE), and Employees Provident Fund (EPF).

31 Financial Intermediation per GDP accounts for 3.47%.（2011/2012 Nepal Rastra Bank） It has been decreased significantly from 2005/2006 when the flow of remittances headed for the speculative investment in real estates making use of lack of regulation.

32 Based on Nepal Rastra Bank Act 2002.

As of July 2012, there were only three public commercial banks in operation, namely Nepal Bank, Rastriya Banjiya Bank, and Agricultural Development Bank[33]. Other banks were private commercial banks (of which total 7 banks are registered as joint venture between the private and public sectors).

Financial banks licensed and regulated by the central bank are 32 commercial banks (class "A" financial institutions), 88 development banks (class "B" financial institutions), 70 finance companies (class "C" financial institutions), 24 microfinance organizations (class "D" financial institutions), 15 savings and loan associations, 36 NGOs, 25 insurance companies, 54 remittance service companies, and 238 moneychangers[34].

On the other hand, financial institutions licensed and regulated by the MoF are 25 insurance companies, NEPSE, Employee Provident Fund, Citizen Investment Trust, Deposit and Credit Guarantee Corporation, Credit Information Bureau, Postal Saving Bank[35], and approximately 10,600 savings and loan associations[36].

Furthermore, there are a large number of informal financial institutions that are regulated by neither the central bank nor the MoF. For instance, there are approximately 2,300 finance associations and 190 small farm associations, of which only 20 organizations are regulated. Also there are approximately 15,000 NGOs engaged in financial intermediary service, of which only 47 are regulated. Thus, many farmers and microenterprises depend on service by financial institutions that are not regulated in terms of management and protection of depositors[37].

The rapid growth of financial institutions and their activities, including non-banks that handle large remittance equivalent to 4.5 times the country's export value, has far exceeded the central bank's supervisory capacity. In response, the central bank encourages the merger of financial institutions. According to a central bank officer, financial institutions in the Nepal capital market are excessive in number and the central bank takes a strong lead in their reduction through merger and acquisition. It targets to reduce the number of financial institutions by half in the next three years[38].

[33] The government is a minority shareholder of Nepal Bank and a majority shareholder of other two banks to control their operation and management.

[34] Source: Nepal Rastra Bank (as of July 2012): however, at the time of an interview with the director general in charge of supervision of banks and financial institutions on December 10, 2012, it was stated that there were 32 commercial banks, 19 development banks, 69 finance companies, and 25 microfinance organizations.

[35] Postal Saving Bank is regulated and supervised by the Ministry of Information and Communications.

[36] Savings and loan associations are regulated and supervised by the Ministry of Co-operatives and Poverty Reduction.

[37] World Bank, 'Access to Financial Services in Nepal'

[38] According to the interview with the central bank's director general in charge of supervision of banks and financial institutions (December 10, 2012)

In fact, in 2010, the capital adequacy ratio was raised from 10% to 11%[39]. This is rather high in comparison to the international standard of 8% set by BASEL. In light of the fact that the average capital adequacy ratio was only 3% ten years ago, the regulation puts significant burdens on commercial banks.

Furthermore, the required minimum paid-up capital for commercial banks is set at Rs.2 billion. It was set in 2007 and there is a rumor that it is raised to Rs.5 billion. However, the central bank has officially stated that it would not raise the requirement abruptly. The higher paid-up capital requirement would encourage merger of commercial banks but will also create confusion in the financial industry.

Meanwhile, the director general of Banks Supervision Department in the central bank believes that the merger of financial institutions together with adequate competition leads to the increase in capital and reduction of management costs, which then helps reduce a risk of bankruptcy of commercial banks. The central bank has issued a letter to recommend merger to 24 financial institutions.

(2) Financial Market

Indirect Financial Market has stably expanded in Nepal. As of 2011, total asses amount to 1,158.32 billion rupees, and deposits reach 871.91 billion rupees. Total deposits as percentage of GDP were 64%. Furthermore, loan steadily grew in the same time span. Total loan amount was USD 713.09 billion rupees which is equivalent of 52% of GDP.

80 % of deposits concentrate on commercial banks among the four categories set up by the central bank. Each of development banks and financial institutions, on the other hand, receives 10% of the deposits.Microfinancial institutions and other financial institutions merely collect 0.2% of total deposits.

This proportion is almost the case for the loan share in the market. Microfinance and other financial institutions, however, occupy 1.3% of the market and slightly improves its share compared with the deposits. （See Table 3.5-1）

[39] The central bank require financial institutions to maintain the cash reserve ratio as follows: commercial banks – 6%; development banks – 5%; finance companies – 5%; and microfinance organizations – 2% (note that microfinance organizations may include bonds in cash reserve).

Table 3.5-1 Principal Indicators of Banks and Financial Institutions

Unit：Billion Rupees

| Description | Mid- July 2008 | Mid- July 2009 | Mid- July 2010 | Mid- July 2011 |
|---|---|---|---|---|
| Total Assets | 604.50 | 833.50 | 996.10 | 1,158.32 |
| Total Deposits | 505.70 | 676.00 | 795.30 | 871.91 |
| Total Loans | 358.10 | 495.20 | 622.60 | 713.09 |
| Deposit/GDP Ratio (%) | 62.00 | 68.40 | 67.90 | 64.00 |
| Loans/GDP Ratio (%) | 43.90 | 50.10 | 53.10 | 52.00 |
| **Market Share in Total Deposits(%)** | 100.00 | 100.00 | 100.00 | 100.00 |
| Commercial Banks | 85.60 | 83.40 | 79.40 | 78.90 |
| Development Banks | 5.10 | 7.20 | 9.70 | 11.10 |
| Financial Companies | 8.50 | 8.40 | 10.00 | 9.80 |
| Other Institutions | 0.90 | 0.90 | 0.90 | 0.20 |
| **Market Share in Total Lendings (%)** | 100.00 | 100.00 | 100.00 | 100.00 |
| Commercial Banks | 78.60 | 76.80 | 74.20 | 74.00 |
| Development Banks | 6.60 | 8.70 | 10.60 | 12.50 |
| Financial Companies | 12.10 | 12.10 | 12.80 | 12.20 |
| Other Institutions | 2.70 | 2.40 | 2.40 | 1.30 |

Source：Ministry of Finance `Economic Survey 2012`

Money supply is indicated in the Table 3.5-2. Every year, annual financial policy set up the target for balance of payment and inflation along with money supply. In Fiscal Year 2011, initial annual target was 5 billion dollars surplus of balance of payment and 7 % of inflation. Money supply (M1) was expected to meet 12.5%. After the revision, it was changed to 8% of inflation and 15 % of money supply. Money supply increased due to the Net Foreign Assets which indicates the growth of remittances from abroad. （See Table 3.5-2）

Table 3.5-2 Money Supply

Unit：%

| FY | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 |
|---|---|---|---|---|---|---|---|---|---|---|
| Narrow Money Supply (M 1) | 8.6 | 12.2 | 6.6 | 14.2 | 12.2 | 21.6 | 27.3 | 8 | 5.2 | 13.5 |
| Narrow Money Supply (M 1)/GDP | 17 | 17.5 | 17 | 17.3 | 17.4 | 18.9 | 19.9 | 17.8 | 16.3 | 16.2 |
| Broad Money Supply (M2) | 9.8 | 12.8 | 8.3 | 15.4 | 14 | 25.2 | 27.3 | 30.2 | 12.3 | 17 |
| Broad Money Supply (M2)/GDP | 50 | 51.7 | 51 | 53 | 54.3 | 60.7 | 63.8 | 68.8 | 67.3 | 69.2 |

Source：Ministry of Finance `Economic Survey 2012`

(3) The central bank’s regulation on financial institutions

The central bank’s Regulation Department has 36 staff members in charge of regulatory activity, who are divided into four teams, each consisting of 9 persons and covering different types of financial institutions, i.e., commercial banks, development banks, finance companies, and microfinance organizations. Their regulatory activity is made through close communication with each organization. Regulatory actions are decided by the Regulation Committee.

Supervision Department has a total of 150 staff members, including those in charge of commercial banks, development banks, finance companies, and microfinance organizations, and staff of branch offices. They are responsible for both off-site and on-site supervision. The central bank makes efforts to increase staff to conduct sufficient supervisory activity.

A financial institution that fails to comply with a mandatory directive of the central bank or its policy is subject to any of the following penalties.

- Cancellation of license
- Fine
- Closure of a branch office
- Inclusion in the black list

(4) SME finance

The central bank sets forth various requirements for financial institutions under its supervision, which are designed to encourage SME finance. For instance, the central bank has issued mandatory directives on “loans for the deprived sector” and “direct loans for the agriculture and electricity sectors.”

The mandatory directive on the deprived sector loan requires commercial banks to allocate 4.5% of their loan portfolio to the deprived sector, development banks 4%, and finance companies 3.5%. Commercial banks may lend the required amount to microfinance organizations. The ratio has been raised by 0.5 percentage point each year and will eventually be raised up to 5% for commercial banks. The directive is not applied to microfinance organizations because their business is to provide financial access for the poor.

On the other hand, the direct loans for the agriculture and electricity sectors are designed both to support the agricultural sector that absorbs two-thirds of employment and persons who return from overseas work and to help improve the electricity supply condition. Financial institutions are required to lend 10% of their loan portfolio to the agriculture and electricity sectors.

Furthermore, the central bank recommends commercial banks to lend 20% of loan portfolio to the productive sectors (including agriculture, SME and manufacturing). Although it is not so now, it will soon be changed to mandatory.

Finally, the central bank provides a refinance facility for the productive sectors by supplying a required fund to commercial banks at the following interest rates.

- Productive sector loans: 6%
- Export sector loans: LIBOR + 0.25% (from commercial banks to export companies, loans will be made in foreign currency, mainly the U.S. dollar, at LIBOR + 2.5%, that is, at 3.5-3.8% in total).
- Loans for poverty reduction: 1.5%

In reality, however, these policies and directives are not complied with and not implemented by financial institutions. For instance, banks extended the above loans at 9-15% as of January 2013. To improve the situation, the central bank has required financial institutions to report loan interest rates on a quarterly basis. Also, it provides consultation service for bank users who could not obtain loans at the above preferential rates.

### 3.5.2 Comparative Advantage of Financial Institutions and Bottlenecks

While the number of financial institutions increases along with their loans, financial service facilities have not been improved much: per 100,000 persons, there are two bank branch offices and less than one ATM. This means few people (0.002% of population) have access to a bank and less people (0.001%) can use an ATM. These are both the lowest in South Asia. In reality, while there are a large number of bank offices in central Kathmandu, financial service is virtually inaccessible in rural areas. To improve the situation, the central bank has introduced Branch Network Policy, which requires a financial institution that opens a branch office in Kathmandu to open a branch office in a rural region and another in suburbs of Kathmandu. It aims to maintain a bank office per 30,000 persons throughout the country. Furthermore, the central bank provides an incentive to supply non-interest funds to a financial institution that has opened branch offices in nine designated areas; Rs.10 million for commercial banks and Rs.2 million for microfinance organizations.

Partly due to poor access to financial service, the number of depositors has decreased recently. The number of bank account holders per 1,000 population declined from 111 in 2003 to 107 in 2008.

Moreover, there is a problem of disparity between financial institutions. The three largest commercial banks account for 25% of the financial sector's total assets, whereas the remaining 75% are divided among 260 financial institutions. As of 2010, 27 commercial banks owned around 80% of the sector's total assets and liabilities, and other financial institutions, including development banks, finance companies, microfinance organizations hold the remaining 20%.

According to the IMF, Nepal's major financial indicators are relatively good in comparison to international standards, but the risk relating to financial stability seems to be on the rise due to the global financial crisis. In particular, problems are pointed out in relation to real estate exposure[40] (especially loans made by savings and loan associations), including deterioration of collateral and fluidity. Furthermore, there are cases where some nonbank corporations borrow funds from commercial banks to make up for an insufficient bad debt reserve. If they go into trouble, it would adversely affect the entire financial sector.

[40] The total amount of credit provided to borrowers

### 3.5.3 Issues relating to Development of the Financial Sector

Major issues facing the financial sector are protection of depositors by developing the healthy financial market and the improvement of financial access. Among four types of financial institutions (commercial banks, development banks, financial corporations, and microfinance organizations), many companies rush to commercial banks for loans because their interest rates are lowest among others. Also, commercial banks have advantages in terms of the speedy loan process and good compliance. On the other hand, development banks and financial corporations attract companies that cannot obtain loans from commercial banks. It should be noted that, before reorganization in 2007, development banks originally played an important role in supply of funds for infrastructure development and other important projects. Now they are maintaining a rather ambiguous, opaque position in the financial market.

Another characteristic of the financial market in Nepal is that, due to entry restriction imposed on foreign financial institutions, lenders take full control of the market. As a result, all loans must accompany personal guarantee (collateral), i.e., there is no non-recourse loan[41]. This market environment causes the financial cost and risk for companies to increase unduly, thus creating a high barrier for business startup or market entry.

Also, companies do not have any other channel of fundraising. The companies listed in the Nepalese stock exchange are dominated by financial institutions, accounting for 95% in total. This means that financial institutions play the leadership role in both direct and indirect financing for risk hedging purposes. The country does not have a bond market.

To improve the condition, the central bank takes various measures, including the provision of low interest rate loans to financial institutions in order to encourage preferential loans for specific types of borrowers or for specific purposes. However, the preferential loans are rarely provided again the intention of the central bank. Also, the preferential loans are subject to a number of conditions and thus discourage companies to apply for them.

While financial institutions, especially commercial banks, seem to enjoy the “lender’s market” status, they have to bear undue burdens or risks peculiar to Nepal. First of all, they are required to purchase treasury bills at unfavorable rates, which are issued to finance the fiscal deficit. As a result, financial institutions accept deposits at a 3% interest rate to buy government bonds at 0.75%. This back spread virtually causes financial institutions to partially finance the budget deficit. High loan interest rates are then set to make up for the back spread loss, which is thus transferred to borrowers.

[41] The non-recourse loan is a loan which is paid back only from income (cash flow) generated by a specific business or property (liability property) owned by a borrower, who thus does not become personally liable for the loan.

Finally, the lack of the adequate financial infrastructure is another factor for causing loan-related risks and costs for banks and other private financial institutions. For instance, there is no sufficient system to share credit information among financial institutions, which would otherwise lower loan risks and costs significantly[42]. Also, the financial regulation department does not have sufficient power and authority to enforce regulation properly, thus prevent effective implementation of financial policy as intended by the government.

What is needed in Nepal is to promote liberalization of the financial market by taking into account the above factors, which will then lead to liberalization of financial service and expansion of financial products, thus improving financial access and allowing companies to raise much-needed funds at a lower cost.

In January 2013, the Bank of Kathmandu and IFC under the World Bank jointly established the first venture fund for SMEs in the country. It is designed to provide comprehensive support for startup companies, not only fund but technical support (e.g., marketing and management), which is considered to be the key to the success in Nepal. The venture fund will purchase shares of selected SMEs to support capital, while giving necessary assistance and advice. In addition to it, the emergence of a venture fund for social entrepreneurs – engaged in small infrastructure development projects - is highly expected.

[42] Credit Information Center Limited provides credit information for member banks. As of February 2013, CICL provided information for a loan application totaling Rs.1 million or more.

Note: The First Venture Fund for SMEs

(From Republica, January 16, 2013)

On January 15, 2013, the launching of the first venture fund for small- and medium-sized enterprises in Nepal was announced. Business Oxygen (BO2) is planned to start with the total fund of $14 million, of which IFC of the World Bank Group contributes $7 million, The remaining $7 million will be raised by a fund manager, who will soon be appointed through the selection process. The fund will be managed by the Bank of Kathmandu and a think tank and it will primarily supply funds to SMEs that are considered to have high growth potential but cannot gain financial access due to collateral and other conditions.

For each case, the maximum amount of $500,000 will be loaned over five years. Also, the fund will made equity participation by purchasing share of a company, which annual sales and assets do not exceed $3 million and has less than 50 employees.

A prospective company that meets the above requirements will then go through the due diligence process. Note that BO2 will not make equity participation in companies that have started up very recently and those engaged in production of liquor, tobacco, or fire arms.

After the purchase of share, BO2 will provide advisory service, including the development of marketing strategy. At present, BO2 plans to make investment in as many as 7,200 SMEs in the next four years, 50% of which will be located outside the Kathmandu metropolitan area. According to Mr. Ajay Shrestha, who is CEO of the Bank of Kathmandu and a central figure in the project, BO2 aims to achieve an annual 17% return on investment.

Mr. Peter Tropper, Chief Investment Officer of IFC's Private Equity Fund, the decision to participate in the unique venture fund has been inspired by the absence of direct financing service for SMEs in the country to prevent sufficient supply of funds to the sector. IFC also intends to play important roles in training fund managers, including overseas training, and providing technical support for companies that receive funds from the venture fund. As SMEs account for around 90% of companies in Nepal, he expects that most companies can become candidates for BO2's investment.

## 3.6 Local Industries in Nepal

### 3.6.1 Current State of Local Industries

(1) Local industries and products

As outlined in 3.2.1, leading industrial sectors in Nepal are mainly located in the Terai region as well as Kathmandu and its surrounding areas. On the other hand, local industries and products are more evenly found throughout the country including Terai. In this report, local industries refer to clusters of enterprises in certain areas which make use of local resources and traditional techniques. For instance, there are a variety of products using agricultural, forestry and fishery resources, including processed items, such as cash crops, dairy and meat products, herbs, and hatchery fish. Also, there are traditional industries and products that use locally developed skills inherited by a variety of races and ethnic groups. Well-known examples are local industries in Bhaktapur, which have high techniques relating to the processing and shaping of wood and stone, and those in Patan known for metallic and stone carving. A list of specialty products further extends to woven carpets made by people of Tibet descent, Buddhist paintings, and handicrafts and paper products made by local women using traditional techniques. Table 3.6-1 lists products made by traditional cottage industries, as designated by the MoE, which have a wide variety of historical and cultural backgrounds.

Table 3.6-1 List of Traditional Cottage industries in Industrial Policy 2010

1. Hand looms, paddle looms, semi-automatic looms, fabric wrapping; dyeing, printing, sewing (except readymade garment) and weaving through traditional technology
2. Hand woven Radi, pakhi, carpet, pashmina, and dress based on wool and silk
3. Handmade paper and goods based on it
4. Filigree and ornamental items based on traditional crafts
5. Traditional sculpture
6. Handmade utensils and handicrafts made of copper, brass, dhalot, kaash, and German silver
7. Handmade utensils made of iron and items of home use such as knifes, chulesi, sickle and spade and so on
8. Handmade ornaments made of gold and silver, utensils (including valuable, semi-valuable goods, utensils and normal stone fitted)
9. Stone-cutting industries (precious, semi-precious and ordinary stones available in the country)
10. Handmade goods made of rural tanning/leather
11. Industries based on natural fiber including jute, sawai grass, bamboo fiber, grass, cotton threads, allo
12. Stone-art (goods made from stone carving)
13. Pauva, thanka art and other traditional fine art
14. Masks and dolls and toys demonstrating traditional culture
15. Various handicraft items demonstrating traditional culture, musical instruments, and arts
16. Decorative items made of wood, bone, horn, clay, stone and artistic goods made from minerals
17. Ceramics and clay pots

Source: Industrial Policy 2010

Furthermore, various initiatives are made to develop local economic resources by linking tourism resources with agricultural and/or traditional handicraft products produced in respective areas. It should be noted that the current state of these local industries, including output and employment, is not accurately understood because the country's business statistics are limited to ISIC 4-digit classification and do not identify the local industries by category. Nevertheless, it can be safely assumed that they hire a fairly large number of local people in comparison to modern industries that do not develop fully in Nepal.

(2) Development of local industries from the perspective of the OVOP program and its nationwide deployment

The OVOP program in Nepal, which started in July 2006, was provisionally completed in 2011 and is expected to restart as the second phase in the near future. During the first phase, the program provided support for promotion of 15 products and services for 21 districts (actually targeting selected villages within each district) (Table 3.6-2). As in the case in Dolka, it is considered an industrial promotion program in rural areas.

Table 3.6-2 List of OVOP Products in Nepal

| | | | | | |
|---|---|---|---|---|---|
| Bhaktapur | Lapsi | Kaski | Agro Tourism | Sallyan | Ginger |
| Ramechhap | Junar | Dolakha | Lokta | Doti | Basmati Rice |
| Sindhuli | Junar | Syangja | Coffee | Chitwan | Banana |
| Nuwakot | Trout | Jhapa | Supari | Dhanusha | Fish |
| Rasuwa | Trout | Sunsari | Turmeric | Saptari | Mango |
| Bardiya | Bel | Lamjung | Agro Tourism | Palpa | Ginger |
| Lalitpur | Cymbidium Orchid | Myagdi | Timur | Kanchanpur | Banana |

Source：Agro Enterprise Center/FNCCI

In the second phase, it is planned to deploy the program nationwide – although depending on an actual size of the program budget – and 75 districts have already decided on products and services to be promoted under the One District One Product program, which will be formally recommended by district's chamber of commerce and industry. A major feature of these products and services is that they have been selected with an aim to develop new types of local industries, as shifted from the first phase that has exclusively focused on agricultural products, while consideration is given to an effective linkage with local resources, such as traditional handicraft techniques, Buddhist tourism, and Special Economic Zone. In particular, herbal products have been selected by 8 districts, which extend from east to west.

At the same time, successful development of local industries relies heavily on infrastructure development - especially roads - that serves as a driving force for market development. Formation of the system for quality enhancement, improvement of production techniques, and upskilling of marketing is also necessary. Furthermore, tourism resources cannot be commercially utilized without facilities where people can spend money. Finally, human resources and skills available in an area can only be effectively used when proper investment is made to mobilize them as business resources. So far, cases of local industry development producing significant economic benefits seem to be limited to urban areas and their suburbs. On the other hand, if local industries in the Himalaya and other mountain areas and the far-western region are to be developed, public investment should be made to develop necessary infrastructure and provide funds.

(3) Current state of herbal products

Medical herbs and fragrant grasses (generally referred to as herbs) that grow in Nepal amount to 64 species and their annual production reportedly reaches 2,171.5 tons. Table 3.6-3 lists top 20 species in terms of weight or revenue among those reported to the Department of Forest to notify harvesting. On a weight basis, soapnut (Ritta) (which is said to be efficacious for treatment of eczema, psoriasis, and migraine, and which is also used as an ingredient for soap, hair tonic, and shampoo on account of antibacterial and antifungal effect) accounts for slightly less than 30% of the total. Top 5 species hold a 66.2% share and top 20 slight below 90%. In the country as a whole, it is estimated that around 50,000 tons can be harvested annually and 20-30% (10,000 – 15,000 tons, including those reported and not reported to the government) are harvested and sold. Note that approximately 90% of herbs in the country are harvested in natural forests and commercial cultivation is not widely practiced. Recently, the Department of Forest requires planting of a certain number of herbs when people collect them in the forests as a business. Also, a private company started growing herbs in the suburb area of Kathmandu.

Table 3.6-3 Harvested Volume and Value (2009/10)

| | Weight (KG) | (%) | Rank | Revenue (Rp) | (%) | Rank |
|---|---|---|---|---|---|---|
| Soapnut (Ritta) | 594,062.0 | 27.4% | 1 | 1,732,309.4 | 8.3% | 3 |
| Kaulo (balk) | 322,413.0 | 14.8% | 2 | 2,338,126.0 | 11.2% | 2 |
| Nepalese Cinnamon | 231,882.0 | 10.7% | 3 | 417,532.0 | 2.0% | 8 |
| Emblic Myrobolan | 155,915.0 | 7.2% | 4 | 135,180.0 | 0.6% | 15 |
| Lichen | 133,075.0 | 6.1% | 5 | 1,203,425.0 | 5.8% | 4 |
| Rockfoil | 113,034.0 | 5.2% | 6 | 598,515.0 | 2.9% | 6 |
| Utrasum Bead Trea | 74,305.0 | 3.4% | 7 | 13,200.0 | 0.1% | 40 |
| Love Apple | 58,910.0 | 2.7% | 8 | 880,950.0 | 4.2% | 5 |
| Chiretta (Chiraito) | 47,924.0 | 2.2% | 9 | 369,690.0 | 1.8% | 9 |
| Kutki | 37,062.0 | 1.7% | 10 | 555,880.0 | 2.7% | 7 |
| Ecltpta Alpa | 30,500.0 | 1.4% | 11 | 15,250.0 | 0.1% | 38 |
| (Seto) Musli | 29,941.0 | 1.4% | 12 | 178,146.0 | 0.9% | 13 |
| Juniper (leaf) | 19,100.0 | 0.9% | 13 | 38,200.0 | 0.2% | 26 |
| Dalchini | 15,978.0 | 0.7% | 14 | 65,786.0 | 0.3% | 22 |
| Amalbed | 15,200.0 | 0.7% | 15 | 126,000.0 | 0.6% | 16 |
| Barberry | 14,217.0 | 0.7% | 16 | 73,336.0 | 0.4% | 21 |
| Madder | 14,133.0 | 0.7% | 17 | 11,665.0 | 0.1% | 42 |
| Valerian | 13,618.0 | 0.6% | 18 | 200,620.0 | 1.0% | 11 |

| | Weight (KG) | (%) | Rank | Revenue (Rp) | (%) | Rank |
|---|---|---|---|---|---|---|
| Hemlock | 13,345.0 | 0.6% | 19 | 3,149.0 | 0.0% | 54 |
| Anthopogan | 12,977.0 | 0.6% | 20 | 64,885.0 | 0.3% | 23 |
| Caterpillar Fungus (Yarsagumba) | 852.5 | 0.0% | 52 | 8,524,650.0 | 40.9% | 1 |
| Jiwanti | 3,420.0 | 0.2% | 36 | 322,800.0 | 1.5% | 10 |
| Club Moss (powder) | 4,000.0 | 0.2% | 34 | 200,000.0 | 1.0% | 12 |
| Spikenard (Jatamansi) | 8,532.0 | 0.4% | 27 | 170,640.0 | 0.8% | 14 |
| Pawan Ko Bokra | 11,440.0 | 0.5% | 23 | 119,400.0 | 0.6% | 17 |
| Nepalese Pepper (Timur) | 12,709.0 | 0.6% | 21 | 101,672.0 | 0.5% | 18 |
| Bisefez | 10,245.0 | 0.5% | 24 | 90,450.0 | 0.4% | 19 |
| Himalayan Rhubarb | 8,381.0 | 0.4% | 28 | 83,810.0 | 0.4% | 20 |
| Others | 164,351.8 | | | 2,215,496.0 | | |
| Total | 2,171,522.3 | | | 20,850,762.4 | | |

Source: Department of Forestry. Hamro Ban 2010/11.

While demand for herbal products in the country grows rapidly, most herbs harvested are exported without processing or in a semi-processed state. In particular, seven species were exported in large quantities between 2005/06 and 2009/10, namely caterpillar fungus (Yarsagumba), soapnut (Rittha), Kaulo bark, Lichen, Spikenard (Jatamansi), Nepalese Pepper (Timur), and Chiretta (Chiraito) (see Table 3.6-4)[43]. All of them are included in the list shown in Table 3.6-3.

Table 3.6-4 Exported Herbal Species（2005/06-09/10）

| | Number of NTFPs traded | Top Exported Species |
|---|---|---|
| 2005/06 | 65 | Yarsagumba (Caterpillar Fungus), Rittha (Soapnut), Kaulo bark, Lichens |
| 2006/07 | 75 | Yarsagumba, Rittha, Kaulo bark, Lichens, Jatamansi (Spikenard) |
| 2007/08 | 86 | Yarsagumba, Timur, Jatamansi. Rittha, Chiraito (Chiretta) |
| 2008/09 | 79 | Timur, Yarsagumba, Lichens, Rittha, Kaulo Bark |
| 2009/10 | 83 | Yarsagumba, Timur, Kaulo Bark, Jatamansi, Lichens |

Source: Department of Forests.2010. Country Report- Nepal: State of Forestry in Nepal. A Synopsis Report.

Geographical distribution of leading herbs can be inferred from NTFPs/MAPs Business Promotion Strategy (2012 – 2016) prepared by Nepal Herbs and Herbal Products Association (NEHHPA). In the strategy, 20 species were selected as priority NTFPs/MAPs in 12 regions that were delineated from the perspective of biological geography by applying the following three criteria: (1) harvest ability in natural forest; (2) high market demand and prices; and (3) prospect for value addition within the country. Fig.3.6-1 shows the 12 regions and the priority specifies designated for each region. Note that the varieties shown in the map exclude exotic ones. Among the 20 priority varieties, Mentha, Chamomile, Lemongrass, and Dalchini are nonresident, but the former three species are already cultivated in the central and western regions,

[43] According to NTFPs/MAPs Business Promotion Strategy (2012 － 2016), 199 species are shipping or could be exported inthe near future. And also, Department of Plant Resources publishes that more than 700 medical herbs are available in Nepal.

while Dalchini is considered to be cultivatable in the country with good marketability in terms of demand price.

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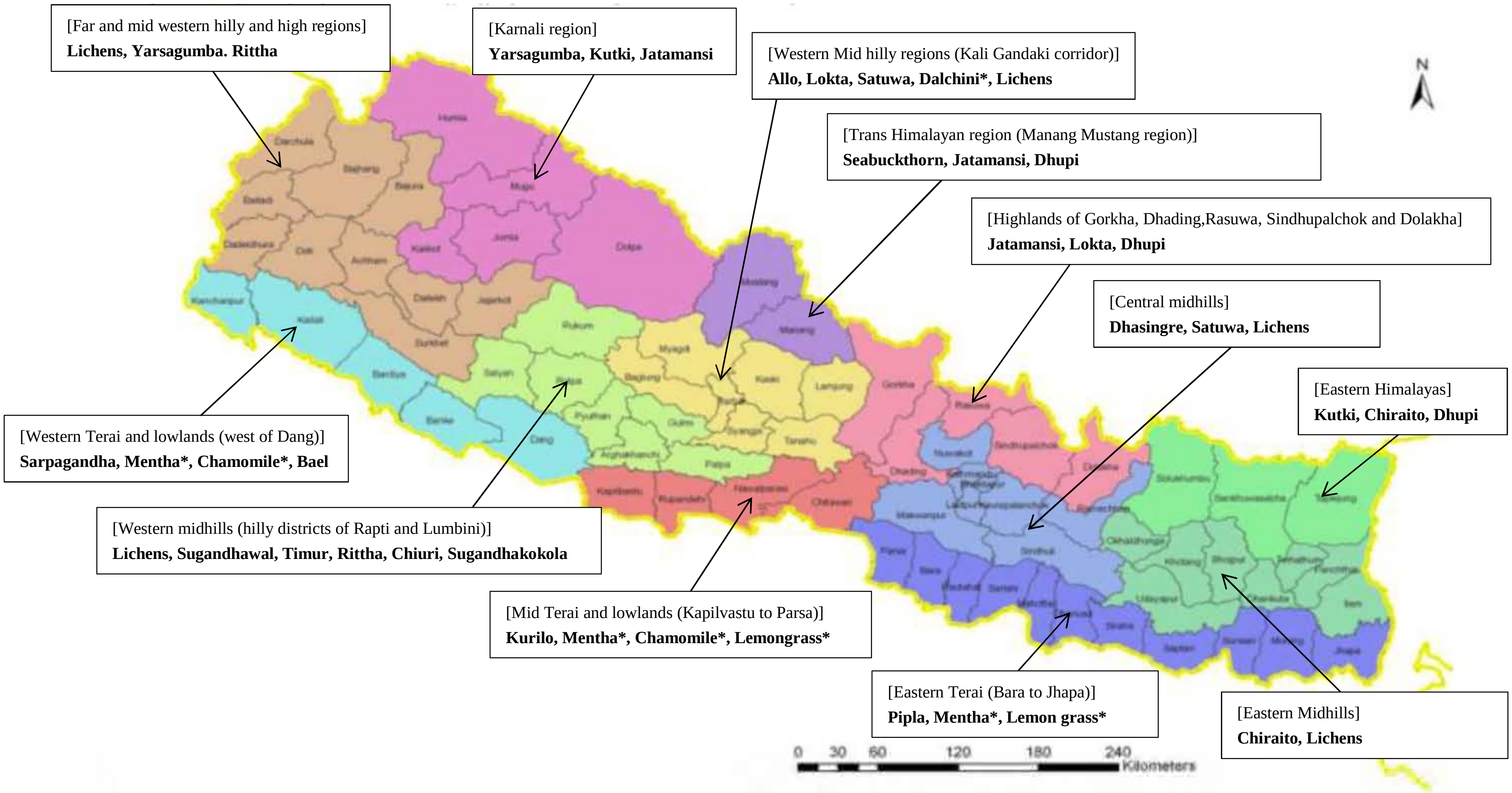


Dipesh Pyakurel & Bhesh Raj Oli. 2012. NTFPs/MAPs Business Promotion Strategy (2012 – 2016) from Private Sector Perspective.

Figure 3.6-1 Priority Species Designated for each Region

(4) Government policy relating to herbs

Key policies, laws and regulations relating to herbs are summarized as follows.

- Private Forest Nationalization Act 1957
- Master Plan for the Forestry Sector 1988
- Forest Act 1993
- Forest Regulation 1995
- Community Forestry Directive, 1996
- Collaborative Forest Management Guidelines,2003
- NTFP Policy 2004
- Community Forestry Guideline, 2009

The government policy is to preserve herbs as natural resource that contributes to the national economy and to aim to establish the country's position as a world depository of herbs. To achieve the goal, the government has set forth specific activity guidelines including preservation and utilization of herbs and NTFPs according to the principle of sustainable development, an emphasis on regeneration, the encouragement of commercial cultivation, promotion of local processing (to add value) under the involvement of the private sector, and public support for development of capital access and infrastructure, accumulation of technical knowledge, and proper market management. Policies and guidelines are also set for the development of certified protocols, simplification of taxation, expansion of research and development activity to local levels, provision of incentives for herb farms, processors and traders, together with provision of training for proper cultivation and processing including market-oriented operation and management.

## 3.6.2 Policies and Programs Relating to Local Industry Development

### 3.6.2.1 Major programs

According to the MoI's policy guidebook, the Nepal government does not have a program that focuses on local industrial development. Instead, it implements training programs targeting micro, cottage and small industries under the titles of human resource development, skill improvement, etc. However, the surveys conducted by the study team have revealed that most of the programs are fairly limited in scope and content due to budget restraint (or shortage of financial source) and/or the shortage of staff at district offices that are expected to take leadership in program implementation. Similarly, the MoA is expected to play a significant role in local industry development, but its involvement is also limited for the same reasons. In particular, the MoA's programs are largely related to cultivation technology (especially grains) and the one village one product project (based on agricultural products) is only one MoA program that serves the purpose of local industry development. Undergoing programs that can be linked to local industry development are outlined below, followed by major issues facing them. (The following analysis is partly reported in 3.2.2.)

(1) Micro-Enterprise Development for Poverty Alleviation (MEDPA)

MEDPA is the MoI's human resource development program focusing on vocational training that leads to immediate income generation. Started in 2009, the program targets the poor, the unemployed, women, and other minorities, and teaches professional skills that are highly demanded regardless of educational background or job experience, such as sewing, indoor shoes making, bicycle repairing, hairdressing, and construction work. The MoI allocates the program budget to district offices of the Department of Cottage and Small Industries and the Cottage and Small Industries Board, which in turn secure training facilities, hire instructors, and recruit trainees to conduct training programs on a non-regular basis (subject to the overall budget allocation). The program budget includes the cost to provide meals for trainees during the training period.

(2) Micro, Cottage and Small Industries Development Program (MCSIDP)

The program has been long implemented by the MoI to help develop human resources for micro, cottage and small industries on a local basis. As in the case of MEDPA, a district office of the Department of Cottage and Small Industries or the Cottage and Small Industries Board plans a training program on the basis of the actual needs in each area, including content and methodology. The program is designed to teach 100 – 200 persons per year. The study team has found that the program covers a variety of skills, ranging from tailoring, piping, wiring, candle making, hairdressing, handcraftsmanship, beekeeping, to business skills including bookkeeping, tax management, and business planning.

Note that, the planning and implementation of MEDPA and MCSIDP programs is subject to prior consultation with the MoI and the District Development Committee.

(3) Employment Generating Fund (under planning)

This is a final support program announced in 2011 to promote business startup. The program is designed to provide low-interest loans (Rs.200,000 each) for groups of entrepreneurs organized in the course of the above vocational trainings or by other means, which are to be used as seed money required for business startup, but it has still to be implemented. A similar program was already implemented for a limited number of years.

#### 3.6.2.2 One Village One Product (OVOP) Program

(1) Introduction of the OVOP concept and program in Nepal

The OVOP movement in Nepal was launched by two organizations - the then Ministry of Agriculture and Cooperative (MoAC) and the Federation of Nepalese Chamber of Commerce and Industry (FNCCI) - in July 2006 as a five-year program (which was positioned as a PPP program). FNCCI had previously implemented the "AID for Trade" program as part of its local industry development efforts, and in the process, it had come to realize the need for commercial development of agricultural products and processed food. In consultation with the

MoAC, it was decided to introduce the OVOP movement that was widely undertaken in Japan and other Asian countries. To design an OVOP program that meets the needs in Nepal, FNCCI studied the OVOP movements conducted in Japan and Thailand (it hired MoAC staff for the purpose) and chose the Thai model because similarity in social and other conditions, while it was designed to constitute an integral part of poverty reduction policy.

After the one-year preparation period including the basic study and consultation with related ministries and organizations, the MoAC announced the “Working Procedure” in May 2006 as a legal basis for implementation of the OVOP movement in Nepal. The program was officially started in July 2006 by establishing the secretariat to manage implementation at FNCCI’s Agro Enterprise Center (AEC), which was responsible for basic study and preparation. It was decided to allocate Rs.35 million as the program budget in the first year, followed by Rs.30 million annually until 2009/10, and Rs.40 million in 2010/11 that was the final year. In practice, however, the actual disbursement in the first year was limited to Rs.15 million due to a delay in budget execution. In addition to the MoAC’s budget allocation, FNCCI and the chamber of commerce and industry in each program area assign full-time staff and provide office space required for program implementation, with free of charge.

(2) Deployment of the OVOP movement in Nepal

The OVOP movement in Nepal was started as a government-led, top-down project, rather than a bottom-up initiative driven by local residents. For example, the MoAC took a lead in selecting 6 districts and 4 products for the initial year program (Table 3.6-5). While a basic OVOP concept of promoting use of local resources is taken into account as a project plan is prepared and submitted by the local chamber of commerce and industry, but the MoAC provides guidance and advice in the planning process. From the second year, a bottom-up approach was emphasized by inviting districts to propose their OVOP plans and establishing the District OVOP Committee consisting of representatives of the local chamber of commerce and industry and members of the District Development Committee, which select and recommend OVOP proposals to the MoAC for final decision. Yet, the actual planning and selection process is far from real bottom-up, i.e., each locality is unable to take leadership in the OVOP process, in which local residents propose and discuss ideas with the District OVOP Committee. This seems to come from government policy that views the OVOP movement as a subsidy program to promote agricultural products in rural areas, opposite to the Japanese OVOP model that emerged in Oita Prefecture. And the planning and selection system remains unchanged.

As of January 2013, the OVOP movement is undertaken in 21 districts for 21 products (OVOP activity is carried out at village level). Note that 22 districts were originally selected, but the “Bael (stone apple) project in Siraha – only one project that was selected without the involvement of the local chamber of commerce and industry – was terminated as local residents discontinued activity, leaving 21 districts. Districts that carry out the OVOP movement, together with respective products, are listed in Table 3.6-4.

Table 3.6-5 Districts and Products under OVOP Movement (2007～)

| Districts | products | Districts | Products |
|---|---|---|---|
| 1st Year | | 4th year | |
| Bhaktapur | Lapsi (candies) | Jhapa | Supari |
| Ramechhap | Fresh Junar | Sunsari | Turmeric |
| Sindhuli | Fresh Junar | Lamjung | Agro Tourism |
| Nuwakot | Trout | Myagdi | Timur |
| Rasuwa | Trout | Sallyan | Ginger |
| Bardiya | Bael (squash) | Doti | Basmati Rice |
| 2nd Year | | Chitwan | Banana |
| Lalitpur | Cymbidium Orchid | Dhanusha | Fish |
| Lekhnath, Kaski | Agro Tourism | Saptari | Mango |
| 3rd Year | | Palpa | Ginger |
| Dolakha | Lokta | Kanchanpur | Banana |
| Syangja | Coffee | | |

Note that the fourth year project was started in November 2012 and visible results have still to be produced. Districts that started the OVOP movement earlier show some results, subject to variation. One thing that fails to measure up to expectations of MoAC and FNCCI is a slow rate of diffusion of the OVOP movement from a village that produces some results to surrounding areas by modeling after a successful project; only a few areas are following suit.

### 3.6.3 Issues Relating to Local Industry Development

Major issues facing local industry development efforts in Nepal are pointed out as follows.

(1) Lack of focus on local industry development as a tangible goal

Programs, which have been so far undertaken to promote, micro, cottage and small industries, seem to be primarily focused on creation of supplemental income sources for local residents by teaching simple skills and knowledge, rather than development of local industry as a whole. Supply of the seed money for business startup can only meet the financial needs incurred during the startup period and is insufficient to foster a full-fledged, sustainable business. Furthermore, despite the fact that Nepal has been producing a variety of local specialties such as handcraft, textile, woodwork, and silver craft, few people in the production side are inclined to commercialize them by making sizable investment. This results in the lack of a conceptual idea in the government side about development of local industry in a particular area; local industry development is considered as a mere extension of public support to create immediate income sources.

(2) Deficiency in development budgeting and the public support system

After 2006, the political unrest delays the policymaking process, including legislation and budgeting to implement public support programs. Also, there is a shortage of personnel at district offices that are responsible for undertaking program activities, together with ministries, partly due to the introduction of the early retirement system for government employees. Coupled with program priority being given to poverty reduction, the government is thus unable to provide assistance relating to local industrial development, in terms of both manpower and budget.

(3) Issues relating to the OVOP movement

As pointed out earlier, the OVOP movement currently undertaken in Nepal is characterized as a subsidy program for development of agricultural production, thus failing to live up to the basic OVOP concept. A major reason for this is the lack of attention to development of human resource (local leaders) that serves as prime mover of a successful OVOP movement. Also, the focus was wrongly placed on the boosting of agricultural production rather than the bottom-up improvement of livelihood and well-being of village people. Under the current program mechanism, nearly 100% of the project cost can be subsidized, encouraging participants to seek ways to maximize the receipt. As a result, the primary objective of the OVOP movement – to make the village self-supporting – tends to be forgotten and participants lose enthusiasm and momentum in due course.

Furthermore, the present OVOP movement in Nepal lacks international perspectives. “Think Globally, Act Locally” is one of the princoples in the OVOP movement in Japan and Thailand. Even in the production using local resources, producers need to think about whether their products are acceptable in the international market. If they settle for low but locally acceptable quality, standards, packaging, and conservation treatment, the movement is not likely to last long. If the movement is to be used as an engine for economic development at local levels, it should be planned and undertaken as an instrument to invigorate local economy from the bottom up, in addition to poverty reduction measures.