



Nepal: Overcoming Distrust in the Market

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I. Introduction¹

An Institute for State Effectiveness (ISE)- Market-Building Initiative (MBI) team has been engaged in Nepal since shortly after the Jana Andolan II.² At the request of key national and international stakeholders, the team has visited at least annually since 2006, and several times in 2008 and 2009. Through a process of Critical Stakeholder Inquiry (CSI) the team has assisted the government and donors in defining the evolving context in the country, outlining assets and constraints to change, indicating the scenarios and drivers for Nepal's future, and setting out key tasks and potential ideas on ways forward.³ In July 2011, at the invitation of the Nepal Economic Forum (NEF), an ISE-MBI team returned to the country to re-engage with critical stakeholders, participate in various events related to the private sector, and update ideas on market-building and leading sector development. This report is not intended by any means to be an exhaustive analysis of the economic context in Nepal. Rather, it takes into account previous findings and provides a brief overview of the current context, outlines some thoughts on the enabling environment for growth, competitive advantage, financial management, and human capital development in the country, and delineates a preliminary set of ideas for potential consideration.

II. Current Political-Economy Context

In successful cases of economic transformation, the role of a stable state based on political consensus has been catalytic in the market formation process through facilitation of the environment for private sector growth. In political terms, despite the apparent frustrations on a quotidian level, significant progress has been made since 2006 in Nepal- the Maoists have been transformed from a movement dedicated to the armed overthrow of the regime to an organized political party; a national election has created a Constituent Assembly including representatives from across the diversity of ethnic, geographical and religious groups in the country; the new assembly abolished the monarchy and declared a Republic; and compromise has been found on a wide range of constitutional concerns.⁴ Comparatively, this represents important positive change that should be applauded.

At the same time, in an economic sense, the development of the country remains, to a large degree, hostage to resolution of the peace process; agreement on the form, shape, and function of the new Nepali state; and the promulgation of the constitution itself. Without certainty as to the parameters of the environment in which business will operate, the domestic private sector is unwilling to make long-term plans, large-scale investment has not been forthcoming, and economic potential remains largely unfulfilled. New cafes and bars are opening all over Kathmandu, but these investments- often funded by remittance flows- represent only cosmetic economic change. The political elite do not yet seem to have grasped the critical importance of the market for a stable and secure Nepal of the future. Indeed, with the influence of the Maoists, the

¹ The ISE team is deeply grateful to the team at Beed and Nepal Economic Forum for facilitating the visit and meetings that provided the basis for this report.

² See www.effectivestates.org and www.aspeninstitute.org/policy-work/market-building

³ See ISE reports *Nepal: The Future in the Present*, May 2006; *Nepal: The Emerging Order*, May 2007; *Nepal: From Politics to Progress*, June 2008; *Nepal: From Stalemate to State-building*, October 2009; and *Understanding State-Transformation: Lessons for Nepal* (event- December 2010).

⁴ A high-level task force and constitutional committee dispute resolution sub-committee have settled 207 of 210 "contentious issues" leaving state restructuring, electoral systems and forms of governance as the key outstanding concerns.

mood of the country is shifting leftwards, away from the market. The reality is that effective and sustainable wealth creation comes from a balance between market-based growth and the reinvestment of some of the outcomes of this growth in equitable social programming. Visible economic progress is becoming increasingly important as political problems persist in Nepal, but at the same time it is precisely the lack of agreement on political issues that is preventing the necessary market-based growth, is resulting in ill-designed redistributive programs, and is perpetuating the current unstable equilibrium.

The Maoists have been brought within the formal political system- and seem unlikely to return to efforts for armed overthrow of the state- but the system is deeply skewed at all levels towards individual and party benefit, rather than the collective good. Corruption and cronyism across a wide breadth of sectors are facilitated by a culture of impunity that pervades governance and the market, undermining the trust of the people both in political actors themselves, but also in the market-based economy more broadly. The system continues because the legitimacy of political actors is derived not from delivery of services, or citizen-focused reforms, but rather from participation in these deeply entrenched patronage networks. While security in general terms has improved across Nepal,⁵ this situation is tenuous because some insecurity still stems from the lack of governance, the absence of economic opportunities for a significant segment of the population, and the sense of inequitable access to power and resources. Patronage politics on one hand, and rising population numbers and slow economic growth on the other, are creating pressure on inadequate state structures, insufficient developmental processes, and long-suffering communities.

Some progress is being made across a number of economic indicators, but significant economic opportunities continue to be missed. That is to say, growth is taking place despite the difficulties the country faces, but the structural changes necessary to truly underpin transformational growth remain elusive. Nepal has a group of creative entrepreneurs that could spearhead a job creation agenda and scale-up their activities, and there is a cadre of leaders and managers within the private sector more broadly that have the skills and capacity to lead economic change. The absence of leadership from a number of key individuals within this private sector community, however, combined with the lack of the enabling environment for growth (as outlined further below), is curtailing business ingenuity and growth.

III. Key Issues

Current concerns should not obscure the fact that Nepal has an impressive set of economic assets- ranging from the social and human capital of the country, to its location as a land bridge between China and India, to its natural resources, and agricultural base. While these have to some extent been mobilized, the noticeable similarity among them is their potential rather than their actualization- the country's economy remains a "tightly wound spring".⁶ The key opportunity in economic terms at this point may be to think through ideas that could provide the basis for change and marshal the country's assets to produce a series of visible benefits for the population. The uncertain political situation is a key constraint, but if a sense of economic momentum can be created in the short-run, even if only nascent, movement towards growth in the medium to long-run may in turn change political dynamics. Indeed, the productive employment of youth in Nepal, a group that represents over a quarter of the population, will also make the critical difference between consolidation of rule of law or fragmentation of authority.

A great deal is expected of the state, the private sector, and cooperatives (see below) in Nepal without a good understanding of what their capabilities are to deliver and where the political will to do so lies. Were the strengths, weaknesses and inclinations for change more clearly understood in the public, private, community, and non-governmental sectors (through truly collaborative competitiveness studies and political-economy analyses), programs could be more easily developed or adapted to context. A brief overview of the economic enabling environment, institutions, leading sectors, financial flows, and human capital might include analysis of the following:

⁵ As of recently, night buses now run on a nightly basis, for example, due to improved security on rural roads. These security improvements can be credited to the home ministry, particularly under the previous home minister.

⁶ Discussions in Nepal, July 2011

Enabling Environment

- i) **Economic Governance.** The increasing dependence of the Nepali economy on remittance flows is having a noticeable and pernicious effect, from a state-building perspective, on the demand for good governance (see **Remittances** below).⁷ As families and communities become increasingly dependent on financial assistance from the diaspora, their interactions with the state become less important and necessary. At the same time, the government itself is becoming less open to policy action in the economic realm because of the remittance safety net. In this vicious remittance cycle, therefore, even less emphasis is placed on economic growth and job-creation, and even more young Nepalis migrate elsewhere. These dynamics are not conducive to governance reform, and indeed, provide an environment in which efforts to prevent constructive change are stifled. The recent resignation of the widely respected Finance Secretary, Rameshwor Khanal, over a supplementary budget and reluctance to punish tax-evaders, is a case in point. Nepal does have a set of institutions and legislation that could generate transparent and accountable government- the Commission for Investigation of Abuse of Authority (CIAA), for example, is more powerful than the proposed Lokpal in India.⁸ The issue arises in terms of implementation and enforcement of rules, and ensuring that bodies responsible for transparent and accountable use of resources are themselves adequately staffed, monitored and overseen.
- ii) **Revenues and Expenditures.** Nepal is demonstrating some progress in terms of public financial management. Revenues have increased significantly- last budget year revenues totaled over Rs 200 million, up from Rs 72 million in 2005/6 through reduction in leakages within the system.⁹ Capacity exists within the financial management architecture that can be built upon and expanded to support accountability mechanisms and programs for improved fiscal management, were such programs to be agreed upon and implemented. On the expenditure side, however, the government continues to commit to a variety of social programs (often politically rather than functionally motivated) that may not prove affordable or sustainable in the long-term. At the same time, a significant expenditure constraint exists in terms of the capital budget, despite recent reforms to streamline processes. In the fiscal year 2010-11, the government spent only Rs 50 million in capital expenditure (just US\$ 700,000 or 39% of the allocated capital expenditure funding).¹⁰ The juxtaposition of unspent government funds, lack of infrastructure and lack of employment opportunities continues to fuel the sense that political discourse is increasingly divergent from the realities of implementation. (For further analysis, see **Construction** below).
- iii) **Cooperatives.** Over the past five years or so, the Maoist emphasis on cooperatives as a central part of Nepal's future seems to have taken root, with the idea of these groups as a third and equal pillar of the economy (alongside the state and the private sector) now articulated in the most recent government budget. The Maoist argument against the market has some validity in the eyes of many Nepalis- given the failure of the private sector to generate necessary growth in Nepal- and some cooperatives have proven incredibly successful in terms of financial, if not productivity gains.¹¹ Given Nepal's well known strengths at the community level, a coherent plan to mobilize cooperatives within a national wealth creation program at the local level, and to scale up their activities through key linkages to markets (for clean electricity, for example) could prove transformative. The initial plans for their development however, does not outline exactly how they will function as a "third pillar", how these connections to larger-scale development plans will be

⁷ As one commentator put it: "a culture of non-performance is setting in". Discussions in Nepal, July 2011

⁸ See Shakya, S. "Nepalonomics!" *Himal SouthAsia*, May 2011.

⁹ Government of Nepal, Ministry of Finance budgets for FY 2005/6 and 2010/11

¹⁰ See Government of Nepal, Ministry of Finance Budget Speech, 2010-11 Annex:

<http://www.mof.gov.np/publication/speech/2011/index.php#>

¹¹ Although the emphasis on cooperatives rattles many in the private sector, who see these developments as a step towards collectivization. Discussions in Nepal, July 2011

made concrete, or how cooperative-led growth will be sustainable. Moreover, the government has begun transferring funds for the creation of cooperatives without knowing exactly what they will do or how best to regulate their activities.¹²

Key Sectors

- i) **Energy.** Debilitating power shortages- due to insufficient generation, poor transmission and mismanagement of supply- continue to undermine productivity. As a result, there remains a national consensus- among the political elite, the business classes and the people- on the critical importance of improvements in the energy sector as a key driver of Nepal's future economic growth. Domestic demand is significant and is increasing at about 12% per annum, while supply is much less than needed.¹³ At the same time, in an era of globalization and environmental consciousness, and positioned as it is between two large and rapidly growing global powers, Nepal is ideally suited to a role as a provider of clean power to both India and China. The government recently doubled state financing of the energy sector to Rs 25 billion; is planning to carry out feasibility studies of over a dozen hydropower projects; and hopes to establish a Power Trading Corporation to manage inter-country trading of electricity. There are also a number of potential private sector initiatives under discussion for the development of large-scale hydro-power plants. The key issue with all of these, however, is implementation- it is imperative that the necessary economic and legal conditions exist in order for these ideas to become realities.¹⁴ In the shorter-term, micro-hydro development through a coherent government-led program still presents the most feasible- and least politically divisive- means of harnessing Nepal's water resources, especially given the country's proven strengths at community-management of development processes.¹⁵
- ii) **Construction.** Nepal faces a significant expenditure constraint- it is not able to spend all budgeted domestic revenue or international funds within any given budget year. The construction sector provides a key area in which the government can work with the private sector to spend revenue on catalytic projects, create jobs and build markets. Emphasis is slowly shifting towards the development of roads that can support market-linkages, but the projects supported by the government do not seem to come together as a coherent program to support economic growth and in any case, implementation is often poor, incomplete or both.¹⁶ There is a market of over 250 million Indians with growing consumer power within a few hundred miles of Nepal- a fantastic opportunity if the right connections can be made. Additionally, only one third of housing in Nepal is permanent, and therefore significant room exists for domestic construction companies to expand operations, if the conditions were in place to do so. On a macro-level, innovative ideas could be considered such as linking a diaspora mutual fund to specific housing developments, or catalyzing deployment of a national infrastructure development bank through partnership with pension funds

¹² Discussions in Nepal, July 2011

¹³ Discussions in Nepal, July 2011

¹⁴ International interest is increasing- the Chinese, for example, are currently undertaking a feasibility study for the hydro-power sector and investing in a number of projects. Brazilian, Norwegian and American companies are also coming into the sector. It is important that a level playing field for investment in the sector is put in place to prevent corruption and mismanagement. The government is now putting in place tax breaks for investment in hydro-power which may go some way towards encouraging interest in the sector.

¹⁵ At the same time, expectations of the communities in the areas with micro-hydro potential are extremely high, and the balance between profitability, local participation and benefits will need to be clearly established and communicated with the population. See ISE Report, *Nepal: From Stalemate to State-building*, October 2009

¹⁶ Traveling through the Terai, close to the Indian border during rainy season provides ample demonstration of the difficulties Nepali traders experience in trying to get their goods to Indian consumers, including washed-out roads, collapsed bridges and insufficient transportation options. Indian donor assistance to Nepal is now the largest of any country and a majority of this support goes to large-scale, turn-key infrastructure projects; ensuring that these projects are coherently aligned with value and supply chain linkages is clearly important.

and the private sector.¹⁷ The key may be for the government to focus on one large-scale project, and follow-through on implementation, to create a sense of progress. In any case, growth in the sector will require close attention to procurement, contracting, vetting of firms, financing and engineering capability, and civil society monitoring- through user scorecards, for example- to ensure transparency and accountability. A national program could also provide a vehicle for support of the construction industry on a small-scale in rural areas through projects funded by block-grants to Village Development Committees (VDCs). Investment in irrigation, for example, could both increase employment in the construction sector in rural areas, and improve agricultural development over the longer-term.¹⁸

- iii) **Agriculture.** The agricultural sector in Nepal contributes 33.8% of the country's GDP and employs 73.9% of the workforce.¹⁹ As a result, any discussion of economic growth must begin with a consideration of how agricultural outcomes can be improved. The recent 2011/12 budget highlighted agriculture as a critical priority for the government over the coming year, with a focus on modernization and commercialization, increased access to agricultural inputs and improved market monitoring.²⁰ It does not, however, indicate how market-based land reform could be thought through more coherently, or how new approaches could improve and expand upon productivity (how cooperatives could be leveraged and brought together to create sustainable, large-scale growth in sectors such as tea, for example)²¹ The use of technology-based, market-focused agricultural platforms and information services are still not widespread in Nepal, despite their successful use elsewhere, and discussions with key players in the telecoms sphere indicates that this is an area of increasing interest.²² Beyond improvements in yield and quality issues, a focus on value added processing for the agricultural goods could maintain competitive advantage by removing external price setting and allowing products to be sold regionally at a far higher price than their initial inputs would have garnered. Exploration of key value added activities (with rice, for example, a determination if there is a demand for processed and enriched rice flour, rice paper, or rice-derived liquors) for domestic or export consumption may prove useful. Relationship-building with key purchasers and distributors of agricultural products can also increase predictability and profitability and ensure quality production.
- iv) **Tourism and Services.** Nepal's potential for tourism is significant, but requires movement beyond low-end trekking and towards the developing higher-end, eco, sustainable and niche tourism.²³ Lessons from countries including Ecuador and Rwanda may be of interest in terms of higher-end

¹⁷ Nepal Telecom, for example, brings in over Rs 10 billion a year- funding that could be harnessed in support of infrastructure development in partnership with the private sector if the appropriate mechanisms could be found.

¹⁸ See ISE Report: *Nepal: From Politics to Progress*, June 2008. A program of this sort could also include a focus on skills-building and project management skills (book-keeping, accounting, time-management and cost estimation), options for encouraging leasing operations, and a particular emphasis on preparation and compliance with procurement and bidding regulations.

¹⁹ Central Bureau of Statistics, *National Labor Force Survey* (2008)

²⁰ See http://www.mof.gov.np/publication/speech/2011/pdf/budgetspeech_english.pdf

²¹ These kinds of developments, as with others in the sectors outlined here, have to be underpinned by more secure property rights to be feasible. The strategy towards production in sectors like tea also warrants careful attention- Sri Lanka invested in high quality tea production but a number of key tea companies (such as Lipton) were not willing to pay a premium for quality. Knowledge of the market dynamics and distributor demand is key, rather than only the quality of the product, unless quality improvement is a value added activity and changes the market segment entirely.

²² See for example the E-Choupal program in India: <http://www.echoupal.com/>

²³ Tourism numbers have been gradually rising since the end of the insurgency- but in 2010, tourists totaled only 500,000. Malaysia, a country with a similar population, registered 24.6 million tourists in 2010. Nepal is making some efforts in this regard- a recent article in Time magazine profiled the rise of gay tourism: <http://www.time.com/time/world/article/0,8599,2083711,00.html> and Nepal is currently organizing the first national literary festival: <http://www.litjatra.com/>

holidaymaking, while management of religious sites and the development of sustainable religious tourism in countries such as Bhutan, Laos and Cambodia may also prove instructive.²⁴ Given Nepal's location, there is huge scope to tap into new markets in China, Russia, and the Middle-East, and to work with the high-quality but low-cost air carriers in India to expand linkages to key Indian cities. Messaging and communication are important here- but there is no reason why perceptions of insecurity will provide an insurmountable obstacle to increasing tourist revenues.²⁵ Religious, medical and educational tourism offer further means by which Nepal could both sell itself to the outside world at a higher point in the value-chain and develop the critical skills it needs across a broader sub-set of activities within the service sector.²⁶ External investors such as China are beginning to demonstrate interest in tourism, but must be provided with the relevant incentives, collectively agreed structures and investment vehicles to make financial support in the sector viable over a longer-term horizon.²⁷

Financial Flows

- i) **Banking.** The banking sector in Nepal suffers from myriad problems including lack of adequate supervision, poor enforcement of rules and licensing procedures, and a nexus of patronage and decision-making. The issue again is not so much that the legislation or rules do not exist, but that implementation is problematic. These are difficult problems involving entrenched stakeholders that will not be easily solved. At the same time, a lack of credit also hinders economic development- with interest rates at 15%, domestic businessmen are unwilling to take out loans, and the concept of project financing still does not seem to have taken root. Without the ability to tap into legitimate financial tools, a significant percentage of the Nepali population cannot participate in the positive benefits of economic growth or begin to generate the savings needed to build an economic base.²⁸ A focus by the banking sector on enforcing rules and implementation of regulation for new approaches, including mobile banking and peer-to-peer lending (as developed in other South Asian countries such as Sri Lanka), seems to be a cost-effective and politically feasible approach that could expand the economic possibilities for Nepalis even in the most remote areas of the country.²⁹ It may also provide the momentum and funds necessary to then address how best to make credit available to larger investors who can lead competitive and employment-generating firms.

²⁴ Rwanda has worked to map potential land productivity, understand critical ecosystems, protect wildlife and areas of natural beauty, and provide the infrastructure and conditions for large-scale growth in tourism. In 2000, just 3,700 foreigners visited Rwanda's national parks, but by 2007, this number had risen to over 39,000, with the sector becoming the highest foreign currency earner.

²⁵ In this regard, Kenya's experience since the post-election violence of 2008, may be instructive. In 2008, tourism receipts in Kenya plummeted over 30%, but despite the economic downturn since then, the country registered record tourist receipts last year through a focus on re-branding, higher-end consumers and new markets in Asia and the Middle-East.

²⁶ The establishment of highly cost-effective, English language Nepali chapters of Indian educational institutions (such as the Indian Institutes of Management) is one idea, for example.

²⁷ The recent problems with the \$3 billion investment in Lumbini by the United Nations Industrial Development Organization (UNIDO) and the China backed Asia Pacific Exchange and Cooperation Foundation (APECFC) are illustrative of how not to negotiate international investment in tourism- the agreement was concluded by individuals without the knowledge of key government ministries including the Ministry of Culture and Foreign Affairs.

²⁸ World Bank figures indicate that 29% of Nepalese households do not have formal access to banking and financial services, and 38% have resorted to informal credit processes, for example.

²⁹ Everest Bank in Nepal is now experimenting with mobile banking. See "Study on Access to Credit for Skill Training Graduates" Nepal Economic Forum Report for Helvitas (2010), p.28

- ii) **Trade and Investment.** Nepal is not yet capitalizing in trading or investment terms from the rapid growth of China to the north and India to the south.³⁰ The adoption of Build, Operate and Transfer projects with foreign companies from these countries could be catalytic, but detailed background checks on these firms are important to ensure effectiveness. Other private sector actors are put off by the fact that doing business is increasingly difficult- Nepal dropped from 112th to 116th in the World Bank's Doing Business indicators over the past year- with constraints to cross-border trade particularly prominent.³¹ Indeed, it can take an average of 41 days and nearly US\$2,000 to comply with export procedures, even before traders have to deal with complicated customs and cargo processing activities. Relatively simple reforms in this regard, such as the provision of electronic data interchange systems and single windows for document processing would facilitate cross-border transactions.³² On a larger scale, the development of Special Economic Zones in selected areas close to key trade routes with India and China, and the completion of key infrastructure projects, to link Kathmandu and the Terai to nodal trading points in Northern India, as mentioned above, may require further thought. Domestically, the cost of capital is also proving prohibitive to investment (and borrowers are required to put up significant collateral) because banks are unable to price the risk of potential loans.³³ As a result, a significant amount of monetary reserves exist in Nepal that are not being used for productive purposes but that could be mobilized behind a coherent strategy for growth.³⁴
- iii) **Remittances.** Nepal's economy is "surviving on remittances", which now total around a third of GDP and constitute a quarter of all household income.³⁵ The negative effects this is having on demand for governance reform are outlined above. Given these dynamics, in an environment of slow global economic growth and instability in the Middle-East (from which the majority of remittances to Nepal originate) this could also become a difficult remittance trap if flows were to decline markedly or without warning. The key to capitalizing on remittance-dependency is to find ways to move away from consumption and transform these flows of money into capital through financial instruments.³⁶ Several approaches might warrant further investigation in this regard: improving the efficiency of individual remittance flows through reducing transfer costs with improved access, better regulation and increased competition among transfer companies; working to ensure that portions of remittance monies are channeled into productive saving and investment vehicles, rather than fueling consumption in their entirety; further movement towards targeted structuring of the diaspora mutual fund currently under discussion in Kathmandu; the development of well-designed, targeted and publicized diaspora bonds (instructive examples include the bonds issued in the past by Israel, India and Sri Lanka);³⁷ and securitization of remittance flows, linked to specific purpose vehicles and with clear oversight and conservative multiples.³⁸

³⁰ Indeed, Indian investment in Nepal declined from \$70 million in 2001-06 to just \$25 million in 2006-11. "Valid Concerns" *Republica*, July 24th, 2011.

³¹ See <http://www.doingbusiness.org/data/exploreeconomies/nepal>

³² See the related report: Bihar: Transformation from a Weak to Redistributive State (August 2011)

³³ Interviews in Nepal, July 2011

³⁴ Estimated at as much as US\$1.5 billion, around US\$200 million of which may be available for productive investment.

³⁵ Discussions in Nepal, July 2011

³⁶ In the early 2000's the banking sector in Nepal was modernized in terms of its infrastructure and capabilities, and consequently the bulk of remittances are transferred through legitimate banking channels- this may make leveraging these flows somewhat easier than in other difficult environments.

³⁷ In 2009, the government of Nepal issued a diaspora bond, but the effort was rushed, poorly marketed, targeted to only a limited group within the diaspora population (migrants in India and OECD countries were not allowed to buy the bonds, for example) and poorly priced (the local currency bond had an interest rate of 9.75% and a maturity of 5 years, while commercial banks in Nepal offer up to 13% on 5-year fixed deposits). This should not detract from efforts to develop a more coherent approach to the idea in the future. The World Bank has recently focused more intently on this issue- see for example the reports and book launched this year by Dilip Ratha:

- iv) **International Aid and Financial Tools.** While some progress has been made in terms of coordinating and harmonizing aid in Nepal, aid flows remain largely project-based and parallel rather than unitary in nature. The aid landscape is crowded and appetite for risk in terms of activities is low- there is room for greater imagination in relation to how the international community could engage in the country.³⁹ India is now the largest donor in the country and China is also increasing aid flows- as a result, Western donors will need to ensure that their interventions are far more focused if they are to be catalytic in the future. If one key priority is market-building and job creation, for example, efforts to bring in new financial tools such as MIGA's Conflict Affected and Fragile Economies Facility (CAFEF) to provide investment and export credit insurance and mobilize private sector actors, might prove catalytic.⁴⁰ The IFC is also in the process of developing a \$14 million SME venture fund (risk capital and advisory services) with local counterparts- the first of its kind for Nepal- which may generate interest in other similar financial structures going forward.⁴¹

Human Capital

- i) **Labor Issues.** As a result of migration, Nepal now faces labor shortages in agriculture and construction. This is raising real wages due to increased demand and also reducing the incentive to work for those that remain, exacerbating labor shortages further.⁴² The solution to this problem has to be a multi-faceted approach to skills-building, job creation and incentive structures. A further critical blockage to economic expansion mentioned continuously by private sector actors in Nepal is the incessant *bandhs* (strikes) and threats of, or actual violence in the workplace related to wages and worker treatment.⁴³ Business leaders argue that current labor laws protect a small minority of unionized workers, making business extremely difficult. This has led to a movement away from precisely the labor-intensive infrastructure projects Nepal needs, given the perceived cost of potential labor disputes. It may be that some entrepreneurs and private sector actors would be willing to accept a relatively high minimum wage if labor rules were amended to ease hiring and dismissal.⁴⁴ At the same time, efforts to improve working conditions (which remain very poor in Nepal generally) may support productivity gains if structured appropriately. More effective mechanisms for dialogue and consensus-building between labor and employers, and implementation of more efficient justice mechanisms in cases of labor law non-compliance would represent significant progress in this regard.⁴⁵
- ii) **Skills and Networks.** There is a distinct mismatch between the skills young people in Nepal need and the opportunities they are provided with. On a macro-level, schools and colleges are not

<http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTDECPROSPECTS/0,,contentMDK:21681739~pagePK:64165401~piPK:64165026~theSitePK:476883,00.html>

³⁸ See the example of El Salvador, where remittance-backed securities were rated investment grade, two to four notches above the sub-investment grade sovereign rating. Investment grade rating made these transactions attractive to a wider range of "buy-and-hold" investors (for example, insurance companies) that faced limitations on buying sub-investment grade. As a result, the issuer accessed international capital markets at a lower interest rate spread and longer maturity.

³⁹ Major donors including the UN and EU agreed on a joint "peace and development strategy" in January 2011. In 2010/11, foreign aid totaled around Rs 22 million or around 25% of GDP.

⁴⁰ Nepal has been named a target country for the facility.

⁴¹ Discussions in Nepal, July 2011

⁴² On a visit to rural areas it is quickly apparent that villages are generally constituted of older people, women and children, as a result of emigration by working age men.

⁴³ Discussions in Nepal, July 2011.

⁴⁴ See ISE report: *Nepal: The Emerging Order*, May 2007

⁴⁵ The ILO recently carried out a survey of labor trends in Nepal: http://www.ilo.org/wcmsp5/groups/public/---asia/--ro-bangkok/---ilo-kathmandu/documents/publication/wcms_151322.pdf but a coherent and highly specific labor market survey has not yet been carried out.

providing the access or knowledge necessary.⁴⁶ This gap can be closed through a more coherent approach to analyzing the problem, building-out appropriate capacity-building programs, and ensuring a broader range of partnerships for implementation, including with the private sector (See **Annex II** for a more detailed discussion of ideas on human development). At the same time, there is an increasing ability and willingness in Nepal- at least among the young, urban population both in and outside the country- to come together, build networks and demand change.⁴⁷ Technology is rapidly transforming the ways in which these constituencies can relate to and communicate with each other, and are spreading rapidly even in rural areas. If the individual talents and ideas of these networks could be collectively mobilized, aligned behind a coherent agenda and fed into discussions and debates on critical issues- ranging from skills-building, to economic governance to employment generation- this would provide a hugely important basis upon which capacities, knowledge and positive change could be generated.

- iii) **Diaspora.** The Nepali economy is not constituted only in Nepal, but rather by the Nepalese people both domestic and global. This economy is based on relationships and networks within a modern global system, which requires a very different approach to that of the past. Migration in itself can be positive- in terms of the effects it has on changing traditional caste based relationships, creating new perspectives, and generating additional income sources. While still nascent, there is a perceptible sense that young Nepalis who may have left the country to work or study abroad, are now seeking to come back to Nepal if possible- indicating a belief in a positive future for the country. Many more young people leave the country than come back- migration is a critical safety valve for Nepal (see **Annex I**)- but this is an important and encouraging development.⁴⁸ Discussions with young Nepalis who have returned indicate that more serious efforts to support their skills development while away may prove useful, including efforts to provide certified training modules connected to financing programs or credit facilities.⁴⁹ At the same time, the government and private sector could become more inventive in the ways in which they work (both separately and in partnership) to attract qualified Nepalis back to Nepal through, for example, targeted job-placement programs, and public service programming and fellowships.⁵⁰

IV. Conclusions

Nepal has huge economic potential, but the lack of agreement on the enabling environment for the private sector is depriving the country economic growth, jobs, and stability. In the absence of this agreement, the informal and corrupt rules of the economic game are becoming entrenched, which is making it increasingly difficult for licit economic actors to operate and for the necessary trade and investment to take place. As a result, distrust of the market continues, and the economy operates in a holding pattern, unable to capitalize on the significant assets that exist or to produce the opportunities that might transform daily lives. It may be that the starting point for improved market-building is for the government to partner with the private sector to focus on just one of these sectors or issues- or several sequentially over the next two to four years- and think carefully about how to put in place the rules, frameworks and mechanisms to ensure

⁴⁶ On a micro-level there are areas of strength. The Kathmandu Institute for Engineering, for example, is training high-quality engineers, on a par with the best schools of the kind in India. Discussions in Nepal, July 2011

⁴⁷ See for example, the “Nepal Unites” group of young Nepalis that has come together on Facebook and Twitter to find voice on a range of issues in Nepal. See Jha, P. “Nepal Unites, But For What?” *Kathmandu Post*, July 5th, 2011

⁴⁸ Around 1,000 young people leave Nepal for the Gulf every day. Discussions in Nepal, July 2011

⁴⁹ Discussions in Nepal, July 2011.

⁵⁰ See for example, the recent establishment of Farkeka Nepali or “Nepali Returnees” network, supported by the Asia Foundation, Birumwa and the Niti Foundation, which is increasingly active on Facebook and has developed a website: <http://farkekanepali.wordpress.com/> Antenna Foundation Nepal, a non-profit organization that provides public service radio, has also recently developed a program entitled “Pharkera Herda America” to “to draw on the experiences, adversities and achievements of Nepalis who lived, worked, and studied in the United States”. See: http://www.afn.org.np/programs_detail.php?id=23

forward progress. Some of the ideas outlined above are less feasible than others, given the current political-economy of Nepal. It may be that where there are areas of consensus (in the power sector for example), progress is possible and negative stakeholders can be sufficiently marginalized if a range of options for action, delineated through clear, understandable “market-building notes” are presented to key policy-makers and leaders, who can then build the relevant constituencies for action.

Annex I- A Youth Perspective⁵¹

No Articulation of a Shared Vision

While it is difficult to generalize as to the sentiments of youth as a whole in Nepal, the sense one gets from discussion with young people is that while they want to improve themselves and improve the country, they cannot articulate a common vision for the future. There is no larger idea or set of goals towards which young people can strive and that could harness their capabilities and provide hope. This leads to the articulation of separate, rather than shared interests in many cases. Young Nepalis do not feel they receive enough support to make their own dreams realities (and indeed, often do not feel the mechanisms exist to create positive change); and also feel that politics has come to dominate decision-making processes about their own access and opportunities in a negative manner. As a result they feel they may become ‘a ‘lost generation’. During discussions, however, too often this leads to assigning of blame rather than consideration of root causes and solutions, and leads to the feeling that identities are mutually exclusive rather than complementary.

Absence of Necessary Support

Universities remain deeply politicized and (with a few exceptions) largely ineffective in providing relevant capacities to match opportunities. Small-scale efforts to help build skills or share ideas for young people are also insufficient (“like putting a teabag in a river”) and an emphasis on entrepreneurship and business is often absent. While there is a deep and impressive desire to learn in Nepal, the aim of learning is often to leave the country rather than improve conditions at home. Around 400,000 young people entered the employment market in Nepal last year, while only 25-30,000 jobs were available within the country, which is leading to widespread migration from the countryside to Kathmandu, and from Nepal more broadly to India, the Middle-East, Asia, North America and Europe.⁵² As a result, it is clear very quickly that rural Nepal is now largely an agrarian society of old people and children, which is rapidly changing social dynamics and rural working patterns.⁵³ At the same time, despite increasing international exposure, young people sometimes seem to be somewhat unsure of Nepal’s place in the world, and how this might, or could change in the coming years.

Hope for a Better Future

Hope for a better future stems from the fact that Nepali youth are hugely energetic, altruistic, hard working, intelligent, and unanimously demonstrate a deep self-awareness and sense of collective responsibility. These are qualities that a future Nepal needs and can mobilize, if the right conditions are put in place. Young people are demanding a more inclusive, responsible and sustainable Nepali state with room for the growth of more accountable leaders from their own ranks. While large numbers of young people are still leaving the country, educated Nepalis are returning from abroad in greater numbers than previously, and this group is committed to building their lives in the country. At present, their desire for positive change within society is not anchored to a coherent agenda or framework, but could prove a dynamic force going forwards if they can build relationships across the country and find a collective direction. Nepal’s young people want to be citizens in a prosperous and dynamic country, not disenfranchised individuals within a divided one. The differences between the various segments of youth can be stark, but if these groups can overcome their differences and build on their shared future as Nepalis, the prospects for the country are very bright.

⁵¹ Based on discussions with youth groups in Kathmandu and Dhadhing district in July 2011 and previous research and analysis on youth issues in Nepal.

⁵² See the British Council’s Youth Survey of Nepal (2011) for comprehensive analysis of youth issues and initiatives in Nepal

⁵³ Communities described over 90% of young people leaving for Kathmandu or for other countries in search of financial gain.

Annex II- Skills Building in Nepal

The key issue as it relates to capacity-building is to understand what skills and preferences exist; develop broader, more inclusive and contextualized training programs; and understand how partnerships can be used to leverage positive change. The following may provide some preliminary ideas on these issues:

- i) ***A Skills and Preferences Survey.*** As part of the reintegration process of former Maoist rebels, a survey is currently under discussion to identify the capacity, knowledge and potential options for these ex-combatants. This will provide a sound basis for understanding how best to ensure a strategic fit between these Nepalis and the current political-economy context. A credible human development plan could be based on a similar, much larger survey of the population- through a series of discussions with ministries, educational institutions, diaspora groups and associations across sectors- to understand more concretely exactly where and to what extent skills currently reside and the approximate numbers of people required to staff the public sector (including doctors, teachers, engineers, and accountants) and private sector (including across agriculture, energy, service industries and construction). The gap between needs and realities, combined with an analysis of priorities among the population in terms of skills-development would allow for a more coherent understanding of how best to engage in human resource development.⁵⁴
- ii) ***A National Skills-Creation Program.*** The emphasis on learning remains abundantly apparent in Nepal- across Kathmandu and other towns around the country, signs for skills courses or English language classes are ubiquitous- but this disparate multiplicity of initiatives must be couched more coherently within a national framework for skills development. A skills survey as outlined above might provide a starting point in this regard, but local ownership and “buy in” to a new agenda for skills building can only occur if such a framework allows for contextualized learning in relation to key sectors and resources and is centered around prior experience and ongoing initiatives where possible. An adaptive program of this type might try to better integrate across educational levels (and ensure equity across geographical ethnic and cultural groups), and equally, allow for tailoring to individual circumstances, through “stackable” and universally recognized vocational credentials for example.⁵⁵
- iii) ***Partnerships to Build Capacity.*** Education is generally perceived as service delivery in Nepal, but a much broader educational constituency exists- both within and outside the country- that could be mobilized to support skills development. This includes civil society groups and NGOs, international educational organizations such as the British Council, and the globalized, forward-thinking segment of the private sector. Discussions with young people indicate that an educational qualification, English language skills or a degree from a foreign university are seen as means by which to leave the country, not necessarily prosper within it.⁵⁶ There are a (small but growing) number of businesses and other organizations in Nepal, however, who are willing to invest in on-the-job training for young Nepalis to support economic growth. Partnerships with universities in the UK and elsewhere on alliances, training and exchanges, and programs with associations of retired professionals across the region and beyond (through both traditional means and using new technologies) may also be worth developing further.⁵⁷

⁵⁴ In the interim, triangulation of the Nepal labor survey, the new census and the national living standards survey could provide an approximate basis upon which to move forward.

⁵⁵ Ideas on skills-building provided by ISE-MBI previously have included: vocational technical education programs to improve project management capacity within the civil service; a tailored incentives program to attract well-educated expatriate Nepalese back to the country; and future leaders training that would target 2,000 youths from within discriminated groups for training necessary to work as high-level government functionaries.

⁵⁶ Discussions in Nepal, July 2011.

⁵⁷ Given the use of the British educational system in Nepal, it makes sense to look further into how the resources of British universities could better be leveraged to support Nepalese students. Informal connections to US universities could also be leveraged through Nepali alumni to ensure the expansion of exchanges and scholarships.

Annex III: Selected List of Persons Met in Nepal, July 2011

Homraj Acharya, Founder, Synergy Foundation
 Ranjit Acharya, CEO, Ogilvy
 Roshan Bajracharya, Economist, World Bank
 Joydeb Chakravarty, Managing Director, J.W. Thompson, Nepal
 Deependra Chamlagain, Program Manager, The Prosperity Foundation
 Amod Mani Dixit, General Secretary, National Society for Earthquake Technology (NSET)
 Kanak Dixit, Editor and Publisher, Himal SouthAsia
 Vidyadhar Gadgil, Associate Editor, Himal SouthAsia
 Ghana Garung, Program Director, WWF Nepal
 Manish Jha, Director of Marketing and Relations, Lead International
 Prashant Jha, Columnist, Kathmandu Post and the Hindu
 Shiva Hari Khatiwada, Reporter, Review Publication
 Madan Lamsal, Chairman/CEO New Business Age
 Sujit Mundul, former CEO, Standard Chartered Bank, Nepal
 Anagha Neelkanthan, Head, International Crisis Group, Nepal
 Jay Nishaant, Deputy Country Director, National Democratic Institute
 Arnico Panday, Assistant Professor, University of Virginia
 Pradip Pariyar, President, Association of Youth Organizations Nepal (AYON)
 Shambhu Poudyal, Director, Nabil Bank
 Sagar Prasai, Deputy Country Representative, Asia Foundation
 Santoshi Rana, Communications Officer, Change Fusion Nepal
 Frederick Rawski, Country Representative, International Commission of Jurists
 Kiran Saakha, Vice-Chairman, Saakha Group and President of the Nepal-Korea Chamber of Commerce and Industry
 Surya Sangachinne, Senior Technical Director, NSET
 Anjib Shakya, CEO, LogicSeed

Suman Shakya, CEO, Cellroti
 Sujeev Shakya, CEO, Beed
 Pranab Man Singh, Quixote's Cove and Nepal Literary Jatra
 Surya Shrestha, Deputy Executive Director, NSET
 Ayano Suzumura, Education Project Manager, Save the Children Nepal
 Luna Shrestha Thakur, Director, ChangeFusion Nepal.
 Sradda Thapa, Columnist, Republica
 Bhim Udas, Patron, Non-Resident Nepali Association
 Rajib Upadhyaya, Senior External Affairs Specialist, World Bank
 The team at Nepal Economic Forum
 The team at Beed management consultancy

A roundtable with Nepali Youth, including:

Bhupendra Jung Shahi, Nepal Student Union
 Nabina Lama, Nepal Free Student Union
 Jagrit Rayamajhi, Revolutionary Student Union
 Renu Chanda, Constituent Assembly Member
 Anuj Chanda, Nepal Young Entrepreneurs Forum
 Vikranta Raj Pande, Partitran Nepal
 Prassidha Pokharel, Paritran Nepal
 Stuti Basnnayat, Nepal Unites
 Rajendra Mulmi, Founder, Association of Youth Organizations, (AYON) Nepal
 Rafel Paudel, Change Fusion Nepal
 Basu Dhakal, CoCap
 Meekha Tuladhar, Private Banker
 Rajneesha Bhandari, Journalist
 Deepti Khakurel, IDEA
 Anita Preeti Thapa, Youth Initiative
 Suphal Ghimire, Researcher
 Rukha Gurung, YUVA
 Erisha Suwal, Nepali diaspora
 Bijaya Paudel, Researcher/AYON

Meetings with local groups in Dhading district