Prospects for Social Justice and Sustainable Development

A Review of Investment, Industrial and Trade Policies of Nepal

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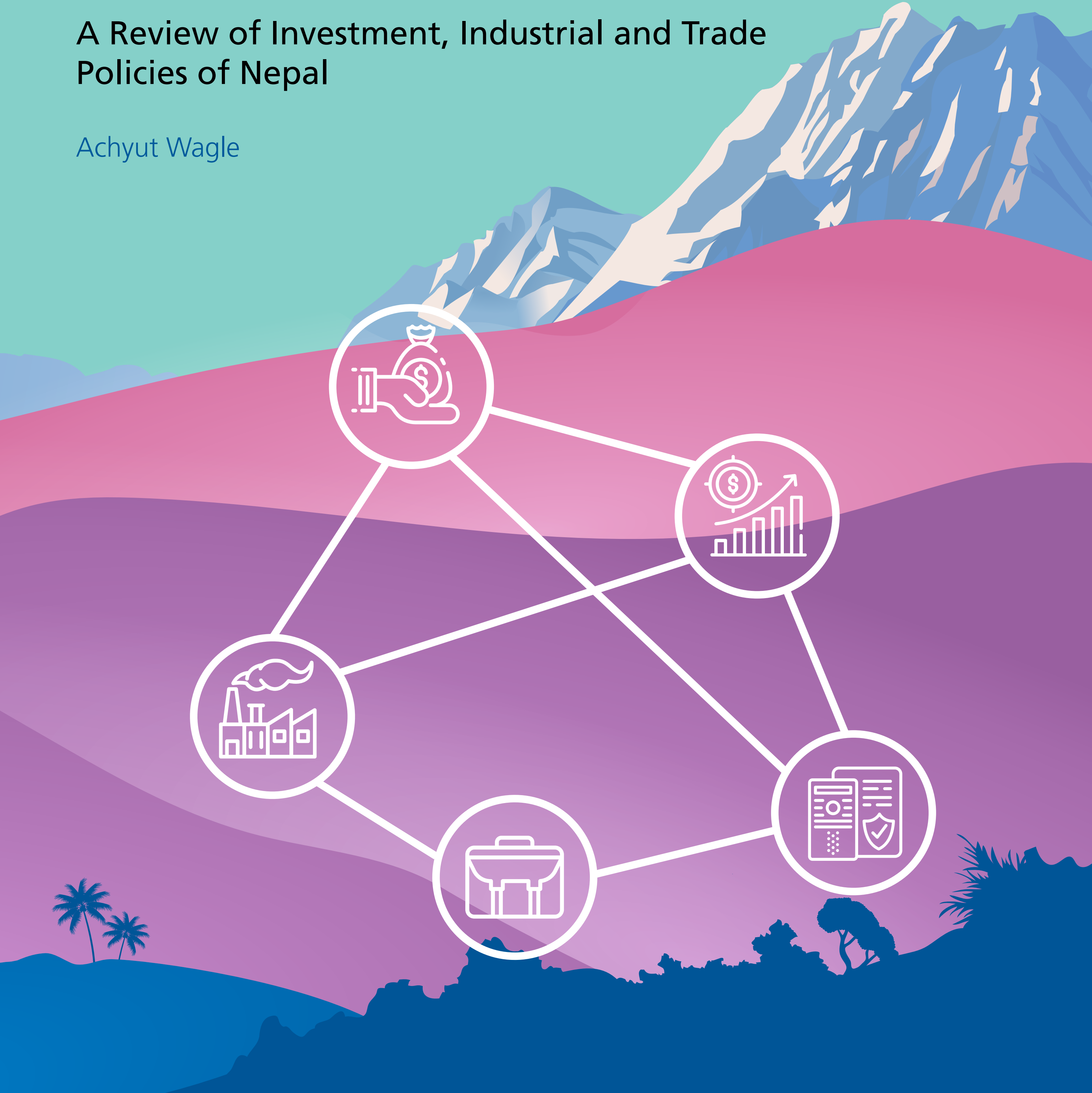

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Background

Nepal's merchandise and service trade deficit amounted to USD 12.54 billion[1] in the fiscal year 2020/21[2] or 34.3 per cent of gross domestic product (GDP).[3] Such a trade deficit is concerning and has recently nurtured fears that Nepal might also face an economic disaster like Sri Lanka. The GDP ratio of the trade deficit has steadily grown and trippled from about 10 per cent in 1970. Even more alarming is the export–import ratio, which has decelerated over the years to 9.2 per cent in the fiscal year 2020/21 (Nepal Rastra Bank, 2021). Total foreign direct investment inflow into the country has never been highly encouraging and amounted only to a meagre USD 166.36 million in that past fiscal year – less than 0.5 per cent of GDP. The ratio of foreign direct investment to GDP persistently remained below 2 per cent over the past decade, except for fiscal year 2014/15, with the annual average ratio in the decade (2010-2020) being 0.9 per cent of GDP. Total domestic investment in industries, on the other hand, has accounted for USD 19.15 billion, or 52 per cent of GDP in 2020 (Department of Industries (DoI), 2020). When this figure is contrasted with the current market capitalization of the 219 companies listed in the Nepal Stock Exchange, at USD 37 billion (as of 20 September 2021), it becomes clear that the level of investment in the productive sector is very low. The contribution of the manufacturing sector to GDP was only 5.1 per cent in 2021 (Ministry of Finance (MoF), 2021a). Overall, the average annual economic growth rate during the past 50 years was only 3.8 per cent. This low economic growth rate for such a long period is an unequivocal affirmation of a comprehensive failure of the economic and developmental policies, and the investment, industrial and trade policies in particular. This, in turn, has perpetuated poverty and limited economic growth.

A vibrant ecosystem comprising investment as well as industrial and trade policies is considered the most benign approach for both economic development and improving the overall well-being of the Nepalese people. As Bhagawati and Srinivasan (2002) argued, "The only developing countries that have registered significant declines in poverty are those that also have integrated faster into the world economy on the dimensions of trade and direct investment". But there are countries like Nepal and others who have been able to reduce poverty not through trade and investment but through remittances and may also require further investment to enhance the skills of the workers. That said, the desirability of the virtuous cycle from investment to overall well-being is axiomatic.

Figure 1: Investment virtuous cycle

In principle, an economy's ability to attract adequate investment, both public and private, including from foreign resources, contributes to the industrial scale of the production of goods and services that can be traded for export or import substitution. An enhanced level of industrial and commercial activities generates income, creates jobs, and increases the overall productivity of an economy, which in turn contributes to reducing poverty and deprivation.

But Nepal has reeled under a vicious cycle of chronic underinvestment, low level of industrialization and infrastructure, low productivity as well as a high dependence on imports and, consequently, a sluggish rate of economic growth. As a result, job creation in the modern formal sector of the economy has remained negligible and disguised unemployment, such as in agriculture, remains disproportionately high. The agriculture sector contributes only about a quarter of the GDP but accounts for about two thirds of the working-age population (MoF, 2021b). Nepal has barely integrated into the world economy through investment and trade flows, and poverty and underdevelopment persist.

[1] Currency conversion is generally based on the US$ and Nepali rupee exchange rate as of 18 September 2021, at $1= 117.27 rupees.
[2] Nepal's fiscal year ends on 15 July or the last of the Nepali month Asar.
[3] Nepal's total nominal GDP as calculated by the World Bank was estimated at $36.6 billion in 2020.

A late start

The foundation for Nepal's industrial development was laid during the last decades of the Rana regime. In a single year, in 1936, the Industrial Promotion Board was formed, and the Company Act as well as the Nepal Patent Design and Trademark Act were adopted. The establishment of the Biratnagar Jute Mills as the first Nepal–India joint venture company followed. Then the government financed the establishment of a few sawmills, match factories, cotton and sugar mills and jute industries, mainly in the cities of Biratnagar and Nepalgunj. In 1940, the *Gharelu Ilam Prachar Adda* (Cottage Industries Publicity Office) was established for the development of cottage and agriculture-based labour-intensive industries. Raghupati Jute Mills was established by private investment in 1946.

Nepal's investments and industrialization have historically remained suboptimal and tokenistic. However, their patterns are connected to different epochs in policy evolution. Before the dawn of democracy in 1951, the **Rana rulers**[1] whimsically set their policy priorities without any clear direction or objectives on the types of industries to be set up and the source of investment. Initially, it was a mixed bag of government investments, joint ventures and private investment of varying equity structures in a limited number of industries.

The advent of **the planning era**, with the formulation of the First Five-Year Plan in 1956, gave rise to a more systematic approach to policymaking, mainly related to investment and industrialization. The motto of self-reliance under the closed economy model governed the policy initiatives and institutional arrangements during the three decades of the Panchayat system[2] under the direct rule by the Shah monarchy, until 1990. The focus was on producing goods that would substitute imports. This was an era of extensive growth of public enterprises of all sorts – textile, tannery and cement industries, cigarette factories and (electric) trolley bus service, to name just a few examples. The investments largely came in the form of bilateral grants from development partners.

A paradigm shift, with a focus on private sector investment, began after the restoration of democracy in 1990. The third and current **phase of the open-market economy** began after the elected government of the Nepali Congress took over in 1992. Policies for foreign direct investment, industrial growth and export promotion, among others, were introduced. The global integration of the Nepalese economy was the driving motto. All possible efforts were made to open the closed economy, integrate it with international markets and attract foreign direct investment to the maximum extent possible.

Yet, Nepal achieved little with these policies, strategies, and initiatives. The country remains a lower-income, import-dependent, unindustrialized and essentially primitive agrarian economy. This is turning out to be a basket case of comprehensive policy failure. The investment, industrial and trade policies have failed to attract foreign direct investment, failed to spur growth, sufficient to transform the lives of the people, miserably failed to generate employment opportunities or improve the export potential of the goods that could extend substantial backward linkages and/or domestic value addition.

There is a plethora of reasons to explain the fruitlessness of Nepal's economic policies, in particular the investment, industrial and trade policies in particular, for so long. This study takes a content analysis approach and descriptive method to evaluate the evolution, effectiveness and gaps in each of these policy areas. Based on this, a number of recommendations for reform will be presented at the end of the analysis.

1 Prime ministerial totalitarian rule founded by Jung Bahadur Rana in 1846, which reduced the Shah kings to a figurehead.

2 A partyless political system introduced by King Mahendra.

Review of Nepal’s investment, industrial and trade policies

3.1 Investment policy

Except for the spontaneous inflow of investment in some joint ventures in the latter half of the 1930s, the practice of formulating policies to attract foreign investment began only in the 1980s. The Industrial Enterprises Act, 1981 and the Foreign Investment and Technology Transfer Act, 1982 were the first laws dedicated to transforming Nepal’s investment climate. But their efficacy back then remained questionable. Required bylaws and other regulations were never formulated. Still, these first two laws set a benchmark.

Periodic plans and fiscal policies since the mid-1980s have provided incentive for investment, including foreign investment. The Foreign Investment and Technology Transfer Act paved the way for the regular inflow of foreign investment and technology transfer into the country (DOI, 2016). The first relatively liberal policy led to the Foreign Investment and Technology Transfer Act, 1992, which repelled the 1982 act. It was complemented by a new Industrial Enterprises Act, 1992, along with the institutional arrangement of the Single Window System for foreign investors. It tried to synchronize the investment, industrial and trade policies. An explicit objective of the Foreign Investment and Technology Transfer Act, 1992, mentioned in its preamble, was to attract foreign investment to “achieve economic growth, to supplement the domestic private investment and increase the access of Nepalese products in the international market”.

Technology was expected to be transferred along with a substantial amount of capital inflow. Provisions were made for 100 per cent equity holding for foreign investors in almost all sectors, for a liberal visa linked to the minimum amount of investment benchmark and for the guarantee of full repatriation of profits and, “if justified”, repatriation of the principal investment. In practice, public sector enterprises were gradually privatized, and the nationalization of private industries was prohibited as a trust-building measure for the benefit of potential private investors.

However, this had not been the first attempt in this regard/Or: This marked a notable break from previous approaches. The First Five-Year Plan (1956–1961) welcomed foreign capital in large-scale industries. The planning document assured investors with protection of their “legitimate interests, including a fair return upon their investments against any arbitrary governmental actions” (National Planning Commission, 1956). The Five-Year Plan also outlined an investment framework comparable to the present-day public-private partnership and aimed for technology transfers in hydropower development. Investment and collaboration were sought “for adequate financing and a well-staffed organization to plan and carry out construction (of hydropower projects) and for agency – public or private – to handle distribution of the power generated”. These types of projects, the document noted, were largely lacking in Nepal.

In the Second Three-Year Plan (1962–1965), the government announced several incentives to encourage both private (then it was termed “non-governmental”) and foreign investment. They included a ten-year tax holiday in profit earnings, a customs duty facility for the import of machinery and inputs and a foreign currency exchange facility for profit repatriation. The government enacted its first industrial policy in 1957 and established the Nepal Industrial Development Corporation in 1959 as an industrial finance company to facilitate industrialization. Several public industries were set up with financial assistance (loans and grants) from donor countries, mainly the United States.

The Third Periodic Plan, which returned to the five-year time frame in 1965, was a leap forward in many respects. It had high ambitions for achieving 19 per cent GDP growth by increasing investment to 9 per cent of the equivalent of the country’s GDP, up from an annual average of 6 per cent. Repatriation of profits on foreign investment in industry was allowed up to 10 per cent of the capital investment in a single year. To repatriate those funds, a foreign exchange facility for up to 25 per cent of the investment was allowed in a year. During the Five-Year Plan period, the domestic private sector was expected to invest about 520 million rupees in agriculture, transportation, industry, and housing. The government planned to invest in the transport, health, and education sectors.

There was little policy departure in the ensuing periodic development plans, at least up to 1985. The plans took a mostly incremental approach to add institutions and reform existing policies. For example, the Fourth Plan envisioned the effective utilization of the labour force, sought to mobilize capital that remained idle in the hands of landlords, after the implementation of the land reform programmes and proposed policy reforms to attract private sector investment to agriculture-based industries.

The Seventh Five-Year Plan (1985–1990) made a significant departure "to further foster the role of [the] private sector in the task of national development" (National Planning Commission, 1965). It was also meant to align with the controversial Structural Adjustment Programme introduced by the International Monetary Fund (IMF) and the World Bank in 1985 to cope with the deteriorating macroeconomic situation, due to a balance of payments crisis in the preceding three consecutive fiscal years. The changes were meant to encourage private sector investment in several sectors and attract foreign investment, also in service sectors. As a result, two joint venture banks – the Nepal Indosuez Bank and the NABIL Bank – were established. To achieve the three articulated aims of encouraging private sector participation to attain national economic development objectives, providing a unified service to the private sector and creating an environment conducive to the expansion of the role of the private sector in the national economy, the Seventh Five-Year Plan contained the following 13 points (ibid):

1. Associate the private sector in government-owned industrial houses and other corporations to mobilize savings.
2. Gradually transfer ownership of the industrial concerns established under the government sector to the private sector.
3. Allow (as a priority) the private sector to establish industries other than those related to defence.
4. Implement more effectively the laws, regulations and policies for encouraging and securing private sector investments.
5. Promote the interests of the private sector through business-like internal competition.
6. Encourage the private sector by promoting foreign investment and establishing a system for such investments.
7. Introduce an institutional system for providing all the facilities needed by the private sector through a one-window system, and gradually extend that system to cover all regions.
8. Free the internal movement of goods from restrictions to develop the country as a national market.
9. Establish a system to encourage the maximum use of domestic products and to support domestic production.
10. Determine the facilities and incentives granted to an industry in the private sector, based on such criteria as contribution to the economy, generation of employment and value added.
11. Review periodically the process and policies of providing loans and regarding customs to make them more amenable to the growth of the private sector.
12. Protect products manufactured in the country by discouraging imports of such items and by encouraging the use of such products in government offices.
13. Discourage monopoly practices (even though the production of essential goods will be protected) by promoting internal competition to safeguard the overall interests of national consumers.

Regardless of the controversy whether or not to call on to the IMF to support Nepal through the Structural Adjustment Programme, it undoubtedly began opening the economy, which tellingly impacted on the investment, industrial and trade policies. Thus, Nepal's modern economic history can be broken down in terms of major paradigm shifts in the investment, industrial and trade policy ecosystem into three eras: the era of self-reliance and import substitution (1936-1965), inward-looking, state-led industrial growth through state-owned enterprises and public investment (1965-1985) and the Structural Adjustment Programme (1985-present). The basis of the policy shift towards export promotion from import substitution, at least in theory, integrated the country's economy into the global economy and reoriented policy and institutional reforms. The policy of economic and financial openness remains largely unchanged.

From 1992 onwards, the democratically elected government rapidly replaced all investment, industrial and trade policies, along with the labour and immigration laws. This paradigm shift prevails until this day. Thus, the Foreign Investment Policy of 2015 was a continued reassurance to potential investors of the openness and global integration of the Nepali economy. This is also reflected in the updates of the 1992 Foreign Investment and Technology Transfer Act and the Industrial Enterprise Act in 2019. And even the periodic development plans, from the eighth Five-Year Plan (1992–1996) to the ongoing fifteenth Five-Year Plan (2020–2024), reflect this policy continuation, with only a few aberrations.

The Company Act, 2006 replaced the 1963 version. The Build and Operate of Infrastructure Act of 2007, the Foreign Investment Policy of 2015, the Public–Private Partnership Policy of 2017 and then 2019 and the Labour Act of 2017 were all meant to improve the (foreign) investment climate and, thereby, industrialization. The Foreign Investment Policy of 2015 revoked the one enacted in 1991 and was expected to complement the missing provisions in the Foreign Investment and Technology Transfer Act of 1992.

3.2 Industrial policy

According to the World Bank (1992), an industrial policy reflects "government efforts to alter industrial structure to promote productivity-based growth". When formulated, an industrial policy considers both long-term and short-term objectives. In the long run, the policy objective is productivity improvements resulting in sustained economic growth, while in the short term, it may have multiple objectives, including employment generation, increased output, better distribution and enhanced productive efficiency by employing the newest technology.

Among Nepal's investment, industrial and trade policies, the industrial policy formulation is the oldest politico–administrative exercise, taking shape from 1936 onwards. The industrial policy is the most critical knot for investment and trade policies. The policy should unlock available but uninvested capital in the financial system and then the increased industrial output enhances the prospects of trade expansion in domestic as well as international markets.

A well-formulated industrial policy is expected to spur the process of industrialization. According to the country's first Five-Year Plan (1956–1960), the initial "successful launching of industries ideally tends to improve the environment for others in terms of public confidence, investment, cumulative skills and availability of auxiliary services". Although the policy initiation to set up industries in Nepal started in 1936, Nepal has experienced only slow and incremental growth over the nearly nine decades since, despite the imperative of transformative leapfrogging towards expansive industrialization.

The first standalone industrial policy appeared in 1957 and was amended and updated in 1962, 1974, 1981 and 1987. The main orientation of all versions was import substitution. The domestic products were supported by high tariff walls and quota restrictions on imports of their close substitutes. Changes in subsequent policies were only marginal and reforms only gradual. The 1974 policy promoted export-oriented industries in addition to import substitution and provided tax incentives to cottage industries proportionate to the amount of initial investment. The 1981 revisions simplified the industry licensing procedures and introduced an improved incentive system based on productivity. The liberalization efforts brought about by the Structural Adjustment Programme had telling effect on the policy and introduced the export promotion zone concept.

The industrial policy of 1987 promoted export-oriented industries by providing incentives, such as pre-export loans, duty drawback system and a bonded warehouse facility (SAWTEE and AAN, 2006). Although licenses were required to establish and expand an industry, foreign investment in selected industries was allowed up to 50 per cent in equity (Ojha, 2011).

One of the most striking features of the industrialization strategy throughout the closed economy era was the establishment of industrial districts, or industrial estates. It started at the beginning of the 1960s and was supported by Nepal's international development partners. Two institutional arrangements made by the government during this period were the establishment of the Nepal Industrial Development Corporation in 1960 and the Industrial Districts Management Limited in 1988.
Of the 11 industrial estates established over time, six still operate (Khatri, 2018).

Table 1: Industrial estates (districts) of Nepal, 2018

Est. year	Industrial state	Financial assistance	Location	Land area (ha)	Number of industries	Employment
1960	Balaju	United States	Kathmandu	34.09	141	4,200
1963	Patan	India	Lalitpur	14.91	118	2,000
1963	Hetauda	United States	Makwanpur	158.73	134	4,100
1972	Dharan	India	Sunsari	10	35	797
1973	Nepalgunj	India	Banke	11.65	35	991
1974	Pokhara	Nepal	Kaski	25.5	89	3,000
1976	Butwal	Nepal	Rupandehi	22.09	72	1,859
1979	Bhaktapur	Germany	Bhaktapur	3.63	37	800
1980	Dhankuta	Nepal	Dhankuta	3.26	N/A	N/A
1981	Birendranagar	Netherlands	Surkhet	4.58	28	300
1986	Gajendra Narayan	India	Saptari	14.96	11	40

Source: Industrial Districts Management Limited (2020).

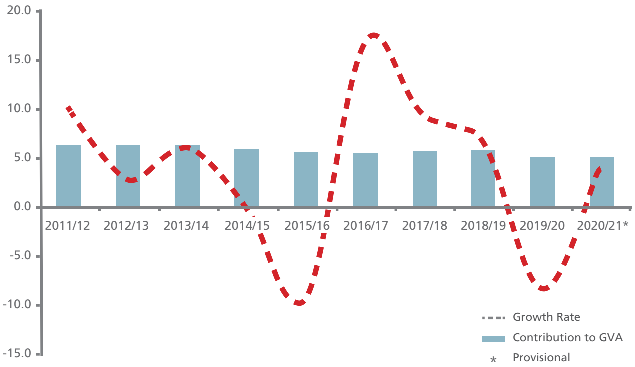
The 1992 Industrial Policy marked a clear departure by recognizing foreign investment as an important element to supplement domestic private investment for achieving economic growth and to link Nepali products with the international market. It aimed to create a backward link to the country's agricultural sector by strengthening linkages with manufacturing "to promote export-oriented industries". The Industrial Enterprise Act, 1992 and the Foreign Investment and Technology Transfer Act, 1992 were in sync with the industrial policy. The Industrial Enterprise Act classified industries both in terms of their initial paid-up capital and by the goods they proposed to produce.

Several policies were coordinated to bring the private sector to the forefront of the country's economic activities through industrialization and the privatization of the state-owned enterprises. But they could not resolutely do away with the principle of state-owned enterprises, and subsequent policy regimes found comfort in a fence-straddling position. That policy confusion still mars policymaking regarding whether the state-owned enterprises, however loss-making they are, should be retained and operated by the state or not.

The 2010 industrial policy incorporated three major new components as its objectives: (i) poverty eradication through broad-based industrial growth, by promoting public–private partnerships, among other forms of investment; (ii) linking biodiversity conservation with agricultural practices; and (iii) making Nepal's industrial sector competitive in line with Nepal's obligation as the member of World Trade Organization (WTO).

The policy aimed to increase the contribution of the industrial sector to the national economy and create strong backward and forward linkages by increasing the use of local resources, raw materials and skills and by promoting value-added exports, respectively. This policy made provisions to establish special economic zones and export promotion zones. Industry classification, protection of intellectual property rights of the industries and special incentives to micro, cottage and small industries were some of its features. This was a policy departure from some four decades of the industrial estate (district) approach to industrialization. This clearly had an outward orientation with focus on inviting foreign direct investment and export promotion.

Figure 2: Industrial sector's contribution to GDP, 2011/12–2020/21



Source: Industrial Districts Management Limited (2020).

But the gross value addition and the growth rate of the industrial sector has been declining. It contributed 9.5 per cent to GDP in 2001 but was a mere 5.1 per cent in 2021. Note: GVA= Gross Value Addition.

3.3 Trade policy

The trade policy barely found its place in the initial periodic development plans. The first Five-Year Plan reviewed the historical and geographical context of both external and domestic commerce. Nepal's foreign trade suffered from its isolationist policy between the mid-nineteenth and the mid-twentieth centuries. Even the entrepot trade between Tibet and India was conducted mainly at the borders, with Nepali buying goods at one frontier to be carried and sold at the other. The first periodic development plan regarded the rugged terrain and unbridged rivers as major deterrents to both domestic trade and along trade channels that mainly ran from northern (Tibetan) to southern (Indian) border points.

The second periodic plan identified the lack of transport and communication infrastructure and connectivity, banking services and trade treaties with potential international trade partner countries as major bottlenecks to trade and commerce. The plan adopted a three-pronged strategy of increasing the volume of trade, improving the trade balance and diversifying trade to reduce single country (India) concentration on both export and import trade.

"We need co-operatives, trade associations and other institutions through which marketing practices can be improved and its channels widened. We need trade promotion through publications and fairs and emporiums. Extended banking and credit and insurance facilities could do much to grease the wheel of commerce and add to its stability," stated the second periodic development plan (National Planning Commission, 1962). It also viewed the increased exports as means to offset the balance of payments deficit.

For the first time in Nepal's planning history, the third periodic development plan (returning to a five-year period) dedicated a chapter to trade policy, with the objective of increasing the volume and variety of products exported and diversifying markets. An import licensing rule to restrict the import of luxury goods was imposed. Changes were made in customs tariffs for such restriction. The National Trading Corporation and the Food Corporation were instituted towards the end of the second periodic plan and during the third periodic plan, respectively. The fifth Five-Year Plan emphasized the importance of exporting processed and value-added goods to fetch higher prices and a "bonus system" on import value was revised to promote exports.

A dedicated trade policy was implemented for the first time in the middle of the sixth Five-Year Plan, in 1983. It included a nine-point programme, under which the provision for cash subsidies was made for overseas exports. Foreign trade was seen as pivotal to "increase production and employment and maximizing the mobilization of internal resources" (National Planning Commission, 1980). The trade policies formulated during the seventh Five-Year Plan aimed to "promote and protect domestic products that can contribute towards the achievement of self-sufficiency in the economy" (National Planning Commission, 1985). It expected the balance of payments to be favourable only if the exports were significantly increased and imports decreased. The Five-Year Plan relied on four institutions to achieve its goals: a Trade Promotion Centre, the National Trading Limited, the Nepal Transit and Warehouse Company and the Cottage Industries Export Development Project.

Apparently, all these policy and institutional arrangements were designed as part of creating a "licensed and protected" economy operating under the self-sufficiency philosophy. As with other policies, a departure in the trade policy came in 1992.

The trade policy of 1992 was one of the pillars of the comprehensive liberalization of the economy initiated by the first democratically elected government. Its major objectives were to "promote internal and international trade, encourage private sector participation, diversify trade in terms of both commodity and destination, promote backward linkages, expand employment-oriented trade and reduce trade imbalances" (SAWATEE, 2007). The policy took a broad approach to cover export and import policies and strategies, domestic trade policy and policy for foreign exchange arrangements, among others. It proposed to create supporting institutions, such as the Trade Council, the Foreign Trade Policy Research Institute and the Nepal Trade Promotion Organization.

The policy continued its overall orientation on export promotion of Nepalese products by enhancing the role of the private sector in all spheres of economic activities. It aimed to raise the quality of exportable products and make them competitive in international markets. The idea was to export high-value (low-volume) products or products with substantial value addition. Identification and development of new products and the exploration of new, particularly international, markets were its priorities. For incentive, it removed the license system (with a few exceptions), exempted duties on imported raw materials and exempted tax on income from exports. On the logistics side, the policy sought to expand the capacity of the bonded warehouse and introduced container service for the transportation of bulk goods.

The next trade policy, in 2009, came about in a significantly changed context – after Nepal became a WTO member. The trade policy claimed to be the most comprehensive, designed to harness benefits of increased market access from the country's WTO membership. The strategies it adopted were the "identification and development of exportable goods of comparative and competitive advantages, ... harmonization of trade and industrial policies with other sectoral policies and developing forward and backward linkages in the agriculture sector, the non-timber forest sector, the tourism sector, service industries and trade" (Ministry of Industry, Commerce and Supplies, 2009).

The main objective of the policy was to support economic development and poverty alleviation by enhancing the trade sector's contribution to the economy. The thrust of the policy was on the promotion of exports and the reduction of the trade deficit. It aimed to establish the relationship between internal and foreign trade. The strategy proposed was to facilitate the private sector to enable it to lead in every economic activity while the government retained the role of guardian, regulator and facilitator. Harnessing the comparative advantage at home and enhancing the competitive advantage in the international markets were articulated objectives of the policy. Domestic consumption was recognized as an important component to expand internal trade.

The 2009 policy introduced two approaches. One, it proposed to create institutions to provide policy and evidence-based support to trade promotion. A Board of Trade headed by the Minister for Industry, Commerce and Supply established a permanent Trade Policy Analytical Wing involving the private sector and setting up an Export Promotion Fund were new propositions in addition to the tweaking of institutional and administrative frameworks related to trade.

Two, the policy introduced the Commodity Development Programme and cited 19 potential export products, divided into two groups. The first was called the Special Focus Area and covered four products already reasonably established in export markets. They were readymade garments, carpets and woollen products, pashmina and silk products and handicrafts. The other group was called the Thrust Area Development that included the following 15 items:

1. tea
2. vegetable seeds
3. *elaichi* (large cardamom)
4. pulses
5. floriculture products
6. gems, stones, silver and gold ornaments
7. processed leather
8. *sutho* (ginger and dried ginger)
9. herbs and essential oils
10. hand-made paper and paper products
11. wooden craft products
12. coffee
13. honey
14. *junar* (a variety of orange)
15. vegetables (fresh and dried).

The first group was deemed to be labour-intensive products and the second lot of products were agriculture and forestry based.

The trade policy was supported by the Nepal Trade Integration Strategy, 2010, which recognized the supply-side constraint as a main bottleneck to Nepal's trade promotion and proposed strategies to ameliorate the problems. It replaced the Diagnostic Trade Integration Strategy, 2004, which was implemented immediately after Nepal became a WTO member.

Both the policy and the Nepal Trade Integration Strategy were outcomes of efforts led by the Ministry of Industry, Commerce and Supply, with financial and substantive support from the United Nations Development Programme, the government of Finland, the United Kingdom's Department for International Development, the International Finance Corporation and the International Trade Centre. The Nepal Trade Integration Strategy, 2010 was a follow-up to the earlier Nepal Trade and Competitiveness Study, 2004, which cited priority actions for the mid of the decade and late decade. When the study was completed, Nepal was not yet a WTO member.

The Nepal Trade Integration Strategy, 2010 was a critical building block in the government's efforts to comprehensively strengthen its ability to coordinate and manage trade-related technical assistance and aid, primarily by implementing the mechanisms of the Enhanced Integrated Framework. Objectives and actions outlined in the Nepal Trade Integration Strategy, 2010 claimed to be closely aligned with those identified for the then forthcoming three-year periodic plan. It was a single shared strategy of the Nepali private sector, development partners and all other stakeholders to develop an inclusive trade sector for the future.

There is reason for these efforts to be called "comprehensive". The strategy paid attention to the market access of Nepali products, non-tariff barriers and regulatory and business environment issues related to exports in import markets. It recognized the need to take steps to strengthen the supply capacity of exporters for them to enjoy competitive advantage in terms of production costs, quality of products and productivity. The Nepal Trade Integration Strategy, 2010 encompassed four objectives to ameliorate capacity constraints: (i) strengthening trade negotiation capabilities, especially in bilateral trade and regional organizations like the South Asian Free Trade Area (SAFTA) and the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC); (ii) strengthening the technical capacity to do away with domestic non-tariff barriers and other business environment-related impediments, including the protection of intellectual property rights; (iii) export prioritization of the selected (19) goods through analysis of potential attractive destination markets; and (iv) strengthening the government's capacity to coordinate and manage trade-related technical assistance and aid for trade to implement the Nepal Trade Integration Strategy.

All these policies and strategies emerged in a period (2004–2015) when Nepal was reeling under profound political transformation, to the extent no one could have predicted. During the political transition of the country from a constitutional monarchy to a federal democratic republic, economic policymaking and implementation of policies were impacted, including the investment, industrial and trade policies.

Another iteration of the trade policy emerged in 2015. It largely extended and expanded the 2009 trade policy. It also had an overarching predilection with "export promotion" and aimed to increase the contribution of export trade to GDP and thereby achieve economic prosperity. According to the Trade Policy Review, "the strategies focus on strengthening supply-side capacity, increasing exports of value-added competitive products and services in the world market and increasing access of goods, services and intellectual property to regional and world markets, among others" (MoICS, 2018).

Effecting policy coherence to enhance the private participation in the entire economy, strengthening the capacity of institutions and institutional arrangements to reduce the supply-side constraints and creating multifaceted links to production, employment, markets and value chains were the goals of the policy. Apart from trade in goods, services and securing trade-related intellectual property rights for Nepali products, it added seven potentially exportable goods and seven services to the list created by the 2009 trade policy.

Seven added goods:

1. sugar
2. footwears

3. textiles
4. instant noodles
5. dairy produc ts
6. iron and steel products
7. cement.

Seven services with export potential:
1. engineering
2. hydropower
3. tourism
4. education
5. information technology and business process outsourcing
6. health services
7. labour services (skilled and semi-skilled professionals for foreign employment).

It also recognized the need for product development with specific Nepali identity to be commercially successful in international markets and the importance of being part of the global value and production chains. Trade-related infrastructure development, such as access roads, ports and transit and transportation facilities, found place in the policy. Trade diversification in terms of products and markets was also envisioned. Providing tax incentives in various forms for exporters was the main strategy adopted to encourage producers and exporters to invest and make extra effort to export. They included a tax holiday, a refund on the purchase of raw materials and cash incentives proportionate to the amount of exports and relative to their type. Additional benefits were available if exporters used local raw materials. The policy claimed to be inclusive in terms of gender and social class: "Programs shall be launched to link micro, cottage and small and medium industries and industries run by women and marginalized classes [or] communities to [the] export sector" (Trade Policy, 2015: 6). It retained the institutional proposition made in the 2009 trade policy, such as the Trade Promotion Institute and the Board of Trade. An annual review and periodic monitoring of the status of implementation were added. The actual status of such provisions is debatable, however.

The National Trade Integration Strategy, 2016 followed and was essentially formulated to implement the 2015 trade policy. It sought to integrate agricultural products into Nepal's trade regime, such as large cardamom, ginger, tea and medicinal and aromatic plants and other products and services deemed to that have high export potential. The product development of potential exportable items, such as coffee, fruits and vegetable juice and honey, were (reportedly) prioritized.
The government carried out a second Trade Policy Review in 2018. The ensuing bulky document largely recorded the salient features of almost all major trade policies Nepal had ever adopted. It made substantial effort to connect the "trinity" of the investment, industrial and trade policies with a much-needed ecosystem approach. A similar review was also carried out in 2012, but both exercises suffered from a selective bias inclined to prove that all the policies announced by the government were "successful", without exception.

Discussion

Regardless of the defence and self-praise in the government-sponsored reviews (2012 and 2018) of the investment, industrial and trade policies introduced over the past seven decades and labelling them as "the best" by the respective policymakers of the time, the cumulative outcome is that Nepal has comprehensively failed to attract substantial investment from any source – public, private or foreign. Industrialization never really picked up, and the trade deficit has only increased in a rather alarming pace over the years. Clearly, none of these policies contributed to economic growth and prosperity in the expected ways and, thus, have failed in delivering on their promises. As the result, Nepal remains one of the poorest nations in Asia.

Why did these policies not even work moderately is an obvious question to further explore. The very objective of introducing them as tools for economic prosperity was often constrained by the lack of sincerity in implementation and the absence of the necessary support systems. Political will and prioritizing often seemed misplaced. For example, throughout the rule of the monarchy (1951-1990), there was an apprehension among all successive rulers that a liberal opening of the economy to the outer world might trigger anti-dictatorial feelings among the population and, thus, pose a threat to the rule of the king. They felt safer to run a protected subsistence economy, expanding it only to the extent of their (political) management capacity under the direct gaze of loyal non-professional managers. Of course, there was the persistent issue of resource constraints, but that situation would have been greatly ameliorated had Nepal adopted a democratic dispensation and become a bead in the global economic wreath.

By the time the economy opened after 1990, it was too late. Many economies that were in a similar poverty-stricken situation had already left Nepal far behind. The reforms that began in 1992 were important and long overdue but quickly lost momentum. Political instability and the Maoist insurgency that began in February 1996 further hampered Nepal's development.

The most impairing lacunae, however, were inherent in the policymaking process itself. The policy proposals were never backed by research or evidence but originated either in political whim or as prescription from donors. They were often too ambitious and populist. Therefore, they lacked ownership and consistency, especially during the political transitions. Moreover, they were highly fragmented across sectors and lacked coherence. The desirable policies and institutional positions, for instance, created through the 2009 trade policy never could realize their potential. A mechanism for impact evaluation and the timely calibration of policies remains absent.

The reform and improvement of certain policies also suffered from continual typecasting. The term "investment" in all the policies, explicitly or implicitly, was mostly referring to foreign investment only. The real importance and prospect of domestic investment and policies to attract the same never seemed to be a policy priority. The bureaucratic mindset of speeding up industrialization by public investment in public sector enterprises remains overarching. Linking industrialization with domestically available raw materials and labour has remained a critically missed component in policy formulation of all forms and for all sectors.

Trade policies claimed to boost exports, whereas the majority of imported daily consumables that ratcheted up the huge trade deficit should have been produced for import substitution, given their potential for local production and consumption. Even when designing export-oriented trade policies, systematic market research in different destinations for varying products depending on their potential demand was never considered.

Ever since the industrial policy of 1957, the nature of incentives has focused on a certain level of tax rebate or tax holidays. Some cash refunds and subsidies on import duties were added in the 1990s. In addition, there were similar incentives for exports. However, these were little more than tokenism and overall inconsistent. Underinvestment in for energy or transport infrastructure as well as other production and transit logistics has become chronic. Long hours of daily power cuts for more than two decades, ending only recently, effectively aborted all ambitious propositions of nearly all investment, industrial and trade policies, however good they were on paper.

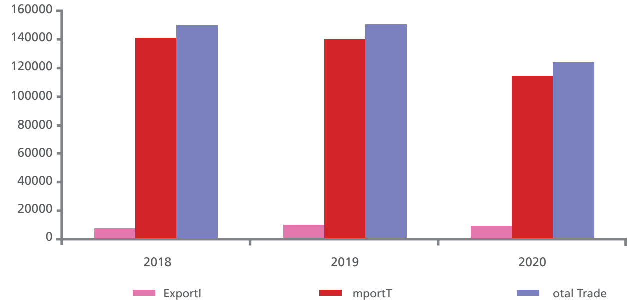
Understanding policies on public investment, industrialization and trade as inseparable components of the same ecosystem and linking them accordingly has been lacking. The governments during the Panchayat era invested in industries like tobacco, sugar, cement, textiles and jute primarily to cater to domestic needs. The products were not expected to support export trade, given the limited scale of production, which did not even cover domestic demand. But the trade policies never ceased to overemphasize their focus on exports. Due to the fact that agriculture-based industries could never draw private investments on a commercial scale and both backward and forward linkages of industries were missing, many efforts had a hard time sustaining.

The trade policies unfailingly mentioned their priority to export promotion but without ever identifying the merchandise goods with which Nepal potentially can develop comparative and/or competitive advantage. Possible destination markets were never properly explored and researched. The successive policies even overlooked the importance of devising strategies to retain a few organically grown markets for some products, such as readymade garments, woollen carpets and handicrafts.

The 2009 trade policy listed 19 goods with export potential. The 2015 policy added seven more items. But the listing was based neither on contemporary research nor on future market prospects. Ironically, the list consisted of those products that for some reason had found a niche international market without any policy support. There was perhaps no harm in listing the way it was done, but such an ad hoc approach neither supported future industrialization nor expansion of trade. The outcome of all these experimentations is, therefore, not very surprising: Nepal miserably failed to attract large investments to speed up industrialization and to promote export trade.

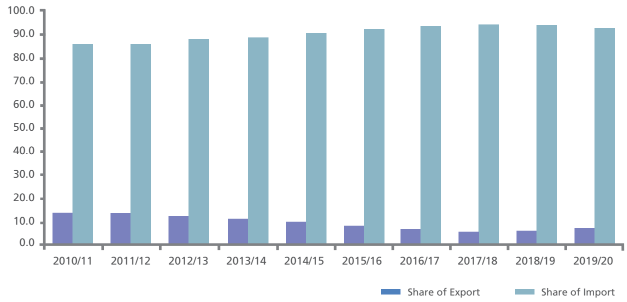
Some other endeavours, such as the trade integration strategies of 2010 and 2016, claimed to align with the corresponding trade polices of 2009 and 2015, respectively, and with the relevant periodic development plans. They were publicized as ‘building blocks’ to coordinate and manage trade-related technical assistance and aid and, thus, to implement the mechanisms of the Enhanced Integrated Framework.

Figure 3: Trend of Nepal’s trade, 2018-2020 (rupees millions)



Source: Nepal Rastra Bank, 2021

Figure 4: Import and export as a percentage of total trade, 2010/11-2019/20



Source: Nepal Rastra Bank, 2021

However, the overall outcome has barely been any different from several past policy exercises. One example is the decelerating export-import ratio over the years.

The Trade Policy Reviews carried out by the Ministry

Conclusion

of Industry, Commerce and Supply in 2012 and 2018 were less of a review and more of a defence of the appropriateness and success of these policies. These sponsored exercises pre-empted a realistic independent review of all policies, thereby, limiting the scope of timely improvements.
Nepal's investment, industrial and trade policies lacks research-based and evidence-based approaches – though, this is not only true for these economic policy areas, but Nepal's entire policy formulation. While some policies certainly have been influenced by the ideological orientations of different governments over Nepal's history, it remains difficult to predict potential policy approaches and outcomes based on election manifestos of the political parties. However, the disconnects between formulated policies and fragmentation of authority across implementing agencies as well as the unpredictable and inadequate incentives and the unsupportive bureaucratic attitude have become rather universal rules in Nepal's policymaking parlance.

To bridge these multifaceted gaps and ensure, at the least, a functional level of policy coherence, like in any other economic policy formulation, an evidence-based ecosystem approach is imperative for investment, industrial and trade policies to succeed. Without substantial domestic inputs of raw materials, labour and energy, the manufacturing sector is unlikely to produce goods that can compete in international markets. To make these products exportable, policies must integrate pricing, quality-control, branding and market-promotion components for each potential export product.

Nepal, also due to its geopolitical compulsions, has effectively failed at trade diversification in terms of products as well as destinations. India remains the largest trade partner of Nepal, with more than two thirds of concentration of the total global trade of Nepal, followed by China, which has increased to more than 15 per cent.

To put a brake on the monumental failure of the investment, industrial and trade policies, there is no other way than to course correct the entire process of policy formulation, implementation and ex-post evaluation. Even if the evidence-based policy formulation is immediately not feasible, basic market research and stakeholder participation approaches might significantly help in recalibrating policies. Giving opportunity to foreign investors to export products to their home markets, identifying products with comparative advantage for industrialization, creating an environment conducive for domestic investment to this end and providing due room to domestic trade, too, can help the investment, industrial and trade policies make tangible contribution to the Nepali economy. If not in the short than at least in the long run.

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