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U N C L A S S I F I E D

AGENCY FOR INTERNATIONAL DEVELOPMENT

Washington, D.C. 20523

PROJECT PAPER

NEPAL
Economic Liberalization
367-0161

Dated: August 8, 1991

U N C L A S S I F I E D

669b

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete)

Amendment Number

DOCUMENT CODE: 3

2. COUNTRY/ENTITY: NEPAL

3. PROJECT NUMBER: 367-0161

4. BUREAU/OFFICE: USAID/NEPAL | 04

5. PROJECT TITLE (maximum 40 characters): ECONOMIC LIBERALIZATION

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM 09 DD 30 YY 96

7. ESTIMATED DATE OF OBLIGATION (Under 'B.' below, enter 1, 2, 3, or 4)

A. Initial FY 91 | B. Quarter 4 | C. Final FY 96

8. COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY 91 B. FX	C. L/C	D. Total	LIFE OF PROJECT E. FX	F. L/C	G. Total
AID Appropriated Total						
(Grant)	(1,200)	(300)	(1,500)	(3638)	(1362)	(5,000)
(Loan)	( )	( )	( )	( )	( )	( )
Other U.S. 1.						
Other U.S. 2.						
Host Country						
Other Donor(s)						
TOTALS	1,200	300	1,500	3638	1362	5,000

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	2. Loan	D. OBLIGATIONS TO DATE 1. Grant	2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	2. Loan	F. LIFE OF PROJECT 1. Grant	2. Loan
(1) SDA	723	840				1,000		1,000	
(2) ARD	279	040				1,000		1,000	
(3) SDA	733	810				1,000		1,000	
(4) EHR	601	690				2,000		2,000	
TOTALS						5,000		5,000	

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each)

840 | 041 | 811 | 690 | 890

11. SECONDARY PURPOSE CODE

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code	BR	BU	INTR	EQTY		
B. Amount	1,000	1,000	1,000	2,000		

13. PROJECT PURPOSE (maximum 480 characters)

To help the Government of Nepal formulate and implement policies that support a pro-market, private sector-led economy; to assist private organizations and firms in using available economic opportunities.

14. SCHEDULED EVALUATIONS

Interim MM 09 YY 93 | MM YY | Final MM 09 YY 95

15. SOURCE/ORIGIN OF GOODS AND SERVICES

☐ 000 ☒ 941 ☐ Local ☐ Other (Specify)

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ____ page PP Amendment.)

17. APPROVED BY

Signature: Kelly C. Kammerer

Title: Director, USAID/Nepal

Date Signed: MM 08 DD 08 YY 91

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM DD YY

August 8, 1991

PROJECT AUTHORIZATION

Name of Country: Nepal

Name of Project: Economic Liberalization

Number of Project: 367-0161

1. Pursuant to Section 106 of the Foreign Assistance Act of 1961, as amended, I hereby authorize the Economic Liberalization Project for Nepal (hereinafter the "Cooperating Country") involving planned obligations of not to exceed $5,000,000 in grant funds over a five year period from date of authorization, subject to the availability of funds in accordance with the A.I.D. OYB/allotment process, to help in financing foreign exchange and local currency costs for the project. The planned life of the project is five years from the date of initial obligation.

2. The Project will: (a) support development of competitive markets by assisting definition and implementation of government policies that advance a pro-market, private sector-led economy and (2) strengthen local private sector organizations and firms enabling them to make use of available economic opportunities.

3. The Project Agreement(s) which may be negotiated and executed by the officer(s) to whom such authority is delegated in accordance with A.I.D. regulations and delegations of authority shall be subject to the following essential terms and covenants and major conditions, together with such other terms and conditions as A.I.D. may deem appropriate.

a. Source and Origin of Commodities, Nationality of Services

Commodities financed by A.I.D. under the Project shall have their source and origin in the Cooperating Country or in countries included in A.I.D. Geographic Code 941, except as A.I.D. may otherwise agree in writing. Except for ocean shipping, the suppliers of commodities or services shall have the Cooperating Country or countries included in A.I.D. Geographic Code 941, as their place of nationality, except as A.I.D. may otherwise agree in writing. Ocean shipping financed by A.I.D. under the project shall, be financed only on flag vessels of the Cooperating Country and countries included in A.I.D. Geographic Code 941 except as A.I.D. may otherwise agree in writing.

b. Condition Precedent to Initial Disbursement

Prior to any disbursement, or the issuance of any document pursuant to which disbursement would be made under the Project Agreement, the Cooperating Country shall furnish in form and substance satisfactory to A.I.D., a statement of the names of the person(s) authorized to represent the Cooperating Country for the project.

c. Condition Precedent to Additional Disbursement

Except as A.I.D. may otherwise agree in writing, prior to any disbursement, or the issuance of any document pursuant to which disbursement would be made under the Project Agreement to finance privatization of industrial parastatals, the Parties shall (1) complete, to A.I.D.'s satisfaction, an environmental review, including an initial environmental examination and environmental assessment (if necessary), and (2) agree upon steps necessary to mitigate negative environmental effects.

Signature: Kelly C. Kammerer
Kelly C. Kammerer
Mission Director
USAID/Nepal

Clearance: PPD/E:NCohen: TA for
PPD:THarris: ___
FM:HJamshed: ___
DD:TWStervinou: ___
RLA:PRamsey: (draft)
PRC:AEisenberg: AE

C

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GLOSSARY

AA	Assistant Administrator, Asia
ADB/N	Agriculture Development Bank of Nepal
ADB	Asian Development Bank
AMA	American Management Association
ATSP	Agro-Enterprise Technology Systems Project
CDSS	Country Development Strategy Statement
CBPASS	Commercial Bank Problem Analysis and Strategy Study
CIPE	Center for International Private Enterprise
FNCCI	Federation of Nepalese Chambers of Commerce
FM	Financial Management (USAID)
FSN	Foreign Service National
GON	Government of Nepal
GEFONT	General Federation of Nepalese Trade Unions
GDP	Gross Domestic Product
GOI	Government of India
GTZ	German Technology Cooperation
GAO	General Accounting Office
HFDC	Housing Finance Development Corporation
IRIS	Institutional Reforms and the Informal Sector Center
IESC	International Executive Service Corps
ILO	International Labor Organization
IEE	Initial Environmental Examination
IQC	Indefinite Quantity Contract
IMF	International Monetary Fund
LDG	Local Donor Group
NCC	Nepal Chamber of Commerce
NORAD	Norwegian Agency for Development
NTUC	Nepal Trade Union Congress
NTUF	Nepal Trade Union Federation
NPC	National Planning Commission
NRB	Nepal Rastra Bank
NGO	Non-Governmental Organization
MOF	Ministry of Finance
MOI	Ministry of Industry
MOC	Ministry of Commerce
OYB	Operational Year Budget
OGL	Operational Guaranteed Loan
PID	Project Identification Documents
PE	Public Enterprise (State-owned firm)
PPD	Program and Project Development (USAID)
PVO	Private Volunteer Organization
PSC	Personal Service Contract
SA	Structural Adjustment (WB and IMF)
SEC	Security Exchange Centre
SBPP	Small Business Promotion Project (GTZ)
TA	Technical Assistance
TAF	The Asia Foundation
USAID	United States Agency for International Development
UNDP	United Nation Development Program
WB	World Bank

I. EXECUTIVE SUMMARY

A. Introduction and Background

Nepal is at a crucial point in it's history. A new constitution and a democratically elected Parliament have created a sense of purpose felt throughout the country. The changed political environment has also led to an important opportunity for major economic reform. Under the Panchayat system, Nepal's private sector was hampered by unnecessary and restrictive controls, limited opportunities, favoritism, and shortages of technical and managerial skills; the private sector contributed a disproportionately small percentage to the country's gross domestic product. The unhealthy private sector policy environment that existed during the Panchayat period also inhibited the establishment of new enterprises and expansion of existing firms, and contributed to growth of the informal business sector. A relatively static gross domestic product, chronic under-employment, and a growing imbalance between imports and exports all reflected a limiting policy framework.

Until now, business expansion has been limited to a handful of industries, such as carpets, handicrafts, garments and tourism. Business sector weaknesses, caused by such things as protectionist policies, an unskilled labor force, illegal trade, subsidized public enterprises (PEs), distrust of the business sector, lack of credit, and an inefficient, often hostile regulatory system, all need to be addressed if the economy is to expand in the 1990s.

The new Government has recognized the need for change, as demonstrated by the Minister of Finance's first Budget Speech and by the policy statement presented to the First Joint Session of the new Parliament by King Birendra. These seminal policy documents recognize that many economic difficulties can be overcome through appropriate policy reforms. A change of attitude and approach can also be assisted by targeted training and selective technical assistance. The Economic Liberalization Project (the project) focuses directly on activities that will assist the Government and the private sector to address these problems.

B. Project Components

The goal of the project is to support the development of a pro-market, private sector-led economy that is strong, stable and self-sustaining. With the support of government and private sector leaders and in collaboration with other donors, the project will help His Majesty's Government of Nepal (HMG/N) to define and implement policies that support a pro-market, private sector-led economy and to assist private organizations and firms take advantage of available economic opportunities.

The project will use a basic strategy of promoting a policy framework that supports private sector-led economic development, through a carefully analyzed, comprehensive policy dialogue process. At the same time, the project will direct support to the business community which will enable it to use those opportunities opened up through an improved policy environment.

Economic Liberalization Project components are grouped into two major, inter-related activity areas: (1) Private Sector Strengthening and (2) Competitive Market Development. To strengthen the private sector, the Project will focus on: local institutions, business skills and trade. As appropriate local institutions, Chambers of Commerce, trade associations, and labor unions, and other business related organizations will be supported, enabling them to better serve their members and provide focal points for information, liaison with the HMG/N, and leadership in promoting the business sector's perspective. Business skills will be improved through highly specific, targeted training programs aimed directly at weaknesses in marketing, management, finance, and technical areas of production. Trade support includes help to export-oriented industries for marketing, world price information, improved technologies, and, if possible, joint ventures/overseas business linkages.

Competitive market development focuses on policy reforms in key areas for business efficiency and growth. Activities important in the policy dialogue process are Regulatory Environment Reform, and the Open Entry System. Reform of the Regulatory Environment is essential for progress in the business sector. Current regulations limit access to the formal business sector, make exporting and importing difficult, and are often arbitrary and contradictory in application. Rules which enhance the capacity of businesses to use opportunities for entry and growth, while protecting consumers' interests and the environment, are fundamental for economic strength and stability. Through analyses of the impact of current regulations and the benefit of changes, an advocacy effort will be launched through education of key decision-makers and influential leaders for new regulations which support equitable growth.

Within the service and production sectors of the business environment, entry and expansion by the private sector have been hampered by regulations, PEs, and an unfocused distrust of private entrepreneurs. Through an Open Entry System to all business sectors, competitive, demand-driven enterprises will emerge and help meet the needs of the market place. The Project will support initiatives which permit new businesses entry to compete with PEs and each other on an equal basis. Also, efforts to encourage and support management contracts of PEs will be made, as will other privatization efforts when politically feasible.

Lack of capital for long-term growth and business development has hindered the business sector. Through programs expanding the number and kinds of institutions and providing training in needed skills, the use of savings and provision of credit for productive purposes can be significantly improved. The private sector needs access to foreign exchange and multiple markets abroad (if they have import/export requirements), yet current systems greatly limit foreign exchange availability and trading ability. The Project will pursue, through policy reforms, improved access to foreign exchange for productive purposes and an expansion of trading options abroad.

Through reform analysis and advocacy, through needs identification and skill development, and through appropriate technical assistance and targeted training programs, the economic environment will be improved and will provide greater opportunities for the private sector to expand and prosper.

C. Cost Estimates

Key inputs for conducting the Project include the provision of technical assistance (international and local) to the business community and the HMG/N, of short-term, targeted training programs in Nepal and abroad, and of a limited amount of commodities to support certain activities. Because the Project focuses mainly on initiatives with the private sector and on a process of policy dialogue, HMG/N and local private sector contributions are extremely difficult to measure and have not been included in the Summary Budget (a waiver of the 25% requirement for non-AID support will be requested). The budget is based on an initial obligation from the Performance Fund of $2,250,000 with further funding from the Mission's Operational Year Budget (OYB) in FY 1993 and FY 1994 to be considered at a later date, depending on the success of the project.

Summary Illustrative Budget

	Item	Total
1.	Technical Assistance	$ 1,360,000
2.	Local Support	219,000
3.	Analyses and Studies	636,000
4.	Training Programs (Overseas and Local)	1,678,000
5.	Commodities	153,000
6.	Mission Administrative Support	418,000
7.	Evaluations and Audit	182,000
7.	Inflation and Contingency	354,000
	Total	5,000,000

Local currenty costs are estimated at $1,362,000 in Nepalese rupees, equal to just over 27% of total costs.

D. Results

All Project activities are directed towards certain basic changes in the business environment: open competition, regulations that facilitate equitable growth, and a pro-market, demand-led economy. Through the creation of a process of dialogue for policy reform, using analyses and key leaders to influence decision-makers, the policy framework for business will be more rational and the consequences of a given action or program better understood, to the ultimate benefit of the business community, consumers, the environment, and the government.

Also, the business community's ability to contribute to policy reform, to create and use opportunities for growth and entry, and to better provide goods and services will be enhanced through the Project. Technical assistance and training will improve business representation with the public and government provide training and information for targeted sectors.

II. BACKGROUND

A. Nepali Business Environment

The manufacturing sector accounts for a little more than 5% of Gross Domestic Product (GDP). This situation is essentially the same as two decades ago. In the past, cottage industry accounted for 33% of GDP in the manufacturing sector. Since the 1980's this proportion has been falling and is currently 18%. Beginning in the 1980s, large new carpet making and garment manufacturing industries have developed, which reduce the relative importance of cottage industries to overall manufacturing portion of GDP. These new industries largely use imported raw materials (e.g., wool), although one objective of current industrial policy is to encourage development of industries based on use of local raw materials.

The woolen carpet industry has been very successful in the last decade. It has expanded rapidly and now accounts for two thirds of all legal exports. It is the largest foreign exchange earner in Nepal and the largest modern sector employer, after government. Its production is based on imported raw materials, with less than 5% of the wool coming from Nepali producers.

Most privately owned manufacturing firms exist in Nepal because of government protectionism either through high tariffs on imported goods or through government provision of below free market foreign exchange. Many of these firms are inefficient and could not compete effectively in an open, competitive system. Combined with the long open border with India and the extremely protectionist economic policies of India (at least those in place before the economic reforms announced in India in July 1991). Many Nepalis have found it more profitable to conduct trade between the two countries to earn immediate returns rather than to establish manufacturing enterprises. This opportunity becomes even more attractive when it involves illegal trade of imported goods to India where imported goods are not available or only at very high prices.

For a variety of reasons, distrust between the government and private sector has grown, resulting in the adoption of restrictive measures, especially with the use of foreign exchange to import raw materials and capital.

In Nepal, it is extremely difficult to obtain long, or even medium-term capital. Because of low returns of those manufacturing enterprises listed in the Securities Exchange, there is less public interest in new share issues, and as a result equity capital is not readily available. A frequent complaint is that the earnings of these firms are not reported correctly as a way to avoid paying taxes and also to avoid paying dividends. Commercial banks are conservative in their lending practices. They normally provide only short term loans (mainly for trade).

The government owns 64 public enterprises of which 29 are in manufacturing. These public enterprises account for 10% of modern sector employment, 20% of output and over 25% of value added. The existence of 64 enterprises in the public sector affects market forces adversely. In areas where public enterprises (PEs) exist, the private sector cannot compete because of protection given to PEs by government. Government controls prices of goods produced by PEs, often creating supply shortages when international or Indian prices are more attractive. Where controlled input prices are cheaper in Nepal than India, inputs flow to India and Nepali producers do not benefit from lower input prices. Similarly, when controlled output prices are lower in India, Nepali traders bring goods into Nepal and sell at higher Nepali prices. The domestic producers of the goods, who are supposed to benefit from higher prices, often find they cannot sell their output because of Indian competition.

There are monopolies in the purchase and distribution of POL products, coal and fertilizers. Prices of these items are controlled and shortfalls are provided in the form of subsidies. Protection through subsidies distorts free market pricing mechanisms and hinders private sector participation in trade and industry, thus robbing consumers of fair and potentially lower prices. Government does not directly restrict private firms from entering most markets, but does not assure fair and equitable operating and pricing conditions for all.

Current industrial policies ostensibly encourage foreign investment in Nepal. Though cottage and small scale industries are reserved for domestic entrepreneurs, foreigners can invest up to 50% of total equity in medium scale industries and as high as 100% in large scale industries if 90% of the production is exported. Though foreign investors can repatriate their capital, interest, cost of technology, and certain compensation in case of nationalization, there have been very few foreign investors. Foreign investors seek out countries that have each things as political stability, policy consistency, simplified registration and licensing procedures, clear cut and transparent government guidelines on taxes and import policy, stability of foreign exchange rate, cargo space, and facilitative customs procedures. Low foreign investment in Nepal indicates the absense of these prerequisites.

In spite of some pro-business industrial policies and acts, implementation problems and regulatory contradictions have negated the benefits of establishing a business in Nepal. Because of inconsistency in existing legislation, lack of clarity and conflicting government policies, regulations are often interpreted by officials in ways which provide the fewest possible benefits to investors. An applicant not only is required to visit concerned officials several times, but also must satisfy each and every officials in order to register a firm, secure bank loans, receive import licenses or export permission. Complicated procedures for registration, taxes, imports and exports have greatly hindered private sector participation and have led to a large informal sector of unregistered businesses, with an emphasis on illegal funding and unauthorized payments.

A recent USAID-funded study on the informal sector has shown it can cost as much as Rs 476,000 ($14,000) in official payments just to get a firm registered. This does not include under-the-table payments. A typical businessman needs to visit eight officials more than 45 times before he obtains a license to open a new business. To get bank loans approved an average entrepreneur has to see eight bank officials 49 times and has to wait 93 days just to get a loan approved by a commercial bank. In spite of all these efforts, chances of getting a firm registered is only 58% and bank loan approval is 75%. Registration is important because unless a firm is registered, it does not qualify for government facilities and incentives or for import/export licenses. Facilities available to registered firms include establishment inside an industrial estate, commercial bank loans, access to foreign exchange and export facilities.

Another study (by the Trade Promotion Center) shows that an exporter on average has to spend nine hours preparing documents and 41 hours making 20 separate visits to offices to collect 122 different signatures. Similarly, import transactions involve 42 different steps, a cost of Rs 1225 for a licence fee and the signature of 88 different officials. The importer will spend an average of 13 hours on documentation and 29 hours calling on the officials. Many businessmen get their work done by going around the system rather than going through all the procedures.

B. <u>Host Country Strategy</u>

Most parties feel the private sector should be motivated more by social responsibility than by profit. Though there is a growing realization that development of the country cannot be done by the government alone, no party has been bold enough to say that the private sector should be allowed to operate in a completely free and competitive environment.

The May 1991 elections resulted in formation of a majority government by the Nepali Congress without coalition partners. The Congress election manifesto commits it to "democratic socialism", reducing inequality, freeing people from hunger, disease and exploitation, ending corruption, labor participation in management, as well as guaranteeing civil rights and freedom. To meet these development goals, the Congress party will require substantial foreign assistance, as domestic revenue meets less than 25% of the development budget.

Just as there are changes taking place in the attitudes of the private sector, there are many senior government officials who understand that past economic policies of protectionism and control have slowed the growth potential of Nepal and that a liberalized economy is needed. The changed political situation has made political leaders, administrators and policy makers more responsive to new ideas and approaches, giving momentum to efforts aimed at longer-term economic liberalization. Dialogue between the government and the business sector has already begun.

C. Relationship to USAID Strategy

The Mission's long-term goals are to promote broad based, sustainable growth to assist policy, administrative and regulatory reforms that encourage private sector participation in production, marketing, distribution, and rural development; and to enhance the ability of the private sector, including firms, Private Volunteer Organizations (PVOs), and cooperatives, to take advantage of a liberal economic and administrative environment.

In accomplishing this goal, USAID faces many uncertainties because the character and policies of the new government are not fully evolved. A number of new ministers profess strong interventionist sentiments. arguing the need for government to play an active role in the economy. Some have expressed a lack of confidence in the abilities of the private sector, as currently constituted. The new government is presently reviewing economic policies as it works to establish its agenda for national development.

The Mission's other projects complement each other and are reinforced by the Economic Liberalization Project. They work toward a sustainable capability within Nepal to be self-sufficient, use limited resources wisely and creatively, and to expand the role of the private sector to provide society with needed goods and services. New efforts in democracy promotion and agroenterprise support dovetail well with economic liberalization by:

- expanding access of farmers, rural groups and agroenterprises to business opportunities and markets;

- increasing the range of choice, availability and use of child survival and family planning services including expanded access through the private sector and better health care financing; and

- endowing private groups and users with control to use and sustain the supply of Nepal's natural resources as part of the Mission's efforts to reorient Nepal away from statist solutions toward working with private groups and reliance on the market.

D. Relationship to Other Donor Activities

Efforts to liberalize the economy are not new. The World Bank (WB) and International Monetary Fund (IMF) are completing their second structural adjustment programs. These have resulted in some reforms in the import tariff regime, simplification of business registrations, and the beginning of an import auction system and Open General Licensing (OGL), which simplify access to foreign exchange. There have been efforts to reduce government subsidies to public enterprises and to allow prices to reflect market conditions (rather than government perceptions of the needs of the people).

In the last year there has been a major shift in the attitudes of donors toward policy reform and the private sector. The legacies of earlier times, where the private sector was small and dominated by Non-Nepalis, and perceptions were that businessmen engaged in illegal activities, are still held by some. Most donors have come to realize that the private sector, given current regulations and policies, has often simply taken advantage of opportunities to improve production and distribution. Donors also perceive the limitations of current policies (especially those dealing with pricing and entry into the formal business sector) and the need for substantive reforms. Nepal's unregulated trade with India is now perceived as taking advantage of faulty policies and providing goods that PEs were incapable of supplying.

Had this project been initiated two years ago, donor coordination would have been limited to discussions with the World Bank and IMF. That is no longer the case. In the design of the Economic Liberalization Project, USAID has worked closely with many donors, learning about their programs and plans, to ensure complementarity of activities. This will be done in two ways: (1) continuation of the frequent discussions with individual donors; and (2) establishment of a private sector sub-committee of the Local Donors Group (LDG). This latter group will encompass the resident donors and make periodic presentations to all donors. Some major actors in economic liberalization and support to the private sector are not members of the LDG. The Government of India (GOI), through the Indian Embassy, supports the largest training program for Nepal and offers more scholarships to study business than all other donors combined. The GOI is actively engaged in assisting Indian businessmen in establishing production or distribution channels in Nepal. Surprisingly, another major donor supporting the private sector is China. To export Chinese factories and capital equipment, they have found few opportunities to sell to government enterprises and therefore are working closely with private firms. This has been increasing over the past year, and as government has less money to put into public enterprises, and as donors are less willing to fund new public enterprises, it is expected that this form of Chinese assistance will grow.

To support business organizations, several donors are working with the apex Nepali chamber body, the Federation of Nepalese Chambers of Commerce and Industry (FNCCI). The Norwegian Aid Organization (NORAD) is providing assistance and support, as is the United Nations Development Program and the International Labor

Organization (UNDP/ILO). Assistance takes the form of staff training, technical assistance, and the development of a research capability. USAID's Agroenterprise and Technology Systems Project (ATSP) is working with FNCCI to develop an Agroenterprise Committee which will provide agroenterprises with information on markets. The UNDP, World Bank and German Technical Cooperation (GTZ) provide limited assistance to trade associations that deal primarily with small or cottage producers. This includes manufacturers of handicrafts, jewelry, and carpets. However, there has not been any support to district chambers of commerce or to trade associations.

In the area of monetary policy and financial markets the dominant donor is the IMF, following the World Bank with the UNDP funding technical assistance in support of Bank and Fund negotiated reforms. The UNDP-funded, World Bank-implemented Commercial Bank Problem Analysis and Strategy Study (CBPASS) of the two government commercial banks has set the tone for much of the work in this area. The UNDP is funding technical assistance needed to restructure the banks, but there is a need for considerable training. The UNDP and World Bank are considering support for this so that it will not be a prime focus for USAID's work in financial market development (discussed in Section III). The IMF does not have the resources to fund technical assistance or any substantial amounts of training. We anticipate working closely with the Fund to help implement those elements of their program involving new financial tools and instruments. The Security Exchange Centre (SEC) has been nearly moribund in trading stocks and relatively weak in raising needed equity. Considerable additional work is necessary to strengthen this institution. It is not expected that in the next five years Nepal will have a thriving equity market, but the stage can be set for slow, steady expansion.

The Asian Development Bank (ADB) has been trying to establish a leasing company. At present there are no tax savings to leasing and government legislation does not recognize leasing as a financial activity. However, the ADB is hopeful of changing the legislation.

Several donors have been supporting PEs in producing and distributing goods and services. While this support has been reduced, it is unlikely to be eliminated totally. On-going donor commitments make it likely that many donors will continue to support PEs. Recently the French decided to revitalize the Nepal Transportation Corporation, at the same time USAID was working to privatize it. The Japanese are helping to construct a new state-owned cement plant, even while the gross inefficiencies and losses of the existing government-owned cement plants (built with donor assistance) require governmental subsidies and retard development.

The World Bank has been active in pushing government to privatize state-owned firms and continues to wait for a demonstration from government that it is serious about making changes. Until then, the Bank does not anticipate its participation in privatization efforts. However, the recent budget message (July, 1991) does send a clear signal of intent to initiate limited privatization and has helped to create a more positive impression within the donor community. Specifically mentioned were increased participation of the private sector in economic development, one window foreign business registration, and the privatization of at least three public enterprises.

Critical to any change in the GON's strategy and policy framework is development of advocacy groups which promote those changes. USAID, working with the UNDP and World Bank, has developed an Economics Discussion Group of senior government, private sector and research economists. The group will meet at least once a month to discuss strategic policy topics. This group should provide ideas for strategy and policy change and how to target resources toward programs aimed at a free market, private sector-led economy.

Training activities will be coordinated with and will complement existing training supported by the Indian Government, the German Small Business Promotion Project (SBPP), the ADB, NORAD and the UNDP/ILO for the private sector, and the UNDP/World Bank's National Planning Strengthening Project.

III. PROJECT DESCRIPTION

A. Goal and Purposes

The goal of the project is to develop a pro-market, private sector-led economy that is strong, stable and sustainable. The Project, with the support of senior government and private sector leaders and in collaboration with other donors, will work toward achievement of two major purposes: (1) to help the GON formulate and implement policies that support a pro-market, private sector-led economy; and (2) to assist private organizations and firms in using available economic opportunities.

B. Project Strategy

The Project will use a straightforward strategy for strengthening the Nepali economy. USAID will work toward the establishment of a policy framework which supports private sector-led economic development, through a comprehensive policy dialogue process. At the same time, we will provide highly focused support to the business community that enables it to productively use new opportunities opened up through an improved policy framework.

The following policy dialogue matrix shows the broad policy areas and changes in focus that will be influenced by the Project. Concentration is on those areas where the U.S. and USAID have comparative advantages. The U.S. is strong in establishment of a positive business environment. This has been achieved

Policy Dialogue Matrix for the Liberalization Project
(in order of priority)

Policy	Priority & Timing	Rationale	Participants (in order of importance)	Donor Activities
Easing business registration and licensing requirements, increasing domestic competition	very high, to begin Fall 1991	A recent USAID funded study and workshop identified the difficulties of registration and licensing as major obstacles in starting new or expanding existing firms, as well as in converting informal to formal enterprises.	Ministry of Industry Ministry of Finance Ministry of Commerce Chambers, Trade Associations, FNCCI	•GTZ's SBPP with small enterprises •UNDP small and cottage industry
Permitting establishment of new financial institutions and instruments, increasing competition in financial markets	high, to begin late Fall 1991	The lack of competition in banking has led to exceptionally high profits for a few joint venture banks, and sloppy procedures in government-owned banks. None have been forced to actively seek new ways of doing business. Many medium and small businesses suffer from lack of access to capital	Nepal Rastra Bank Ministry of Finance Securities Exchange Centre Bankers Association	•IMF and World Bank dialogue on issues •USAID assistance to establish and develop the Securities Exchange Center (SEC) •UNDP assistance to commercial banks (CBPASS) •ADB and USAID assistance to strengthen the Agricultural Development Bank •ADB work to establish a leasing company
Alternatives to state ownership of production and trading enterprises	high, training activities initially, TA spring 1992	Studies by different donors, consultants, and government offices have demonstrated the inefficiency as well as the cost to government and the economy of public enterprises. These are a drain on government resources and siphon-off a substantial amount of loan capital of the state-owned commercial banks	Ministry of Finance (CCD) National Planning Commission Ministry of Industry Ministry of Commerce business community	•World Bank/IFC studies and willingness to help in future •Danida and work on privatization of Dairy Development Corporation (with USAID and Winrock assistance) •USAID training assistance using DTP •Assistance to establish and strengthen public enterprises (PEs) is coming from, for example, Chinese (Butwal Spinning, Lumbini Sugar, Gorakhali Rubber); German (Himal Cement); ADB (Hetauda Cement and other PEs); Japan (new cement factory and Sajha transportation system); France (strengthen Nepal Ropeway)

Policy Dialogue Matrix for the Liberalization Project

Policy	Priority & Timing	Rationale	Participants (in order of importance)	Donor Activities
Strengthening business organizations	high, to begin Fall 1991	Until the return of multi-party democracy, the role of business organizations was very circumscribed, they were supplicants and not partners in development with government. They have been *discovered* by donors who would like to help the private sector. However, they lack the infrastructure or knowledge of how to effectively serve their constituencies or lobby government.	Nepal Chamber of Commerce Jaycees Nepal Foreign Trade Association other district chambers and trade associations	•ILO/UNDP assistance to FNCCI and productivity councils •Norwegian assistance to strengthen FNCCI •USAID ATSP assistance to FNCCI's agricultural-enterprise division •World Bank will establish a FNCCI advisory group, and is considering additional training or support services for FNCCI.
Private sector run training activities	high, to begin Winter 1991	The shortage of trained personnel has acted as a serious brake on business development; local universities are not providing the training needed, nor are enough Nepalis receiving business-skill training in Nepal.	Nepal Chamber of Commerce Jaycees FNCCI trade association district chambers	•ILO/UNDP assistance to Institute of Management at University •Other donors have provided some limited equipment to the University's Institute of Management •USAID private sector training under DTP, proposed training under ATS project. •Over 300 scholarships provided by Indian Embassy for study in India; short courses offered by parent organizations of Indian companies in Nepal
Opening economy to outside and increasing international competition	medium, to begin summer 1992	The high level of protectionism in Nepal has led to inefficiencies and an emphasis on smuggling to India rather than production. The ADB categorized Nepali government attitudes as having an anti-export bias by heavily emphasizing import substitution through protectionism.	Nepal Rastra Bank Ministry of Finance Ministry of Industry Ministry of Commerce Chambers/FNCCI, trade associations	•*Economics Discussion* group •UNDP/International Trade Center, Geneva on export promotion •USAID DTP training activities

through elimination of excessive regulations and bureaucratic layers. The U.S. is a leader in legislation to protect the environment and the consumer, as well as in requiring a safe and healthy work environment without exploitation of women, children, or minorities. The U.S. continues to work towards an equitable tax system which is growth-oriented, understandable, consistent, and pro-investment.

The U.S. has a comparative advantage over other nations in development of financial markets and introduction of new financial instruments. This expertise can be used to help Nepal expand and diversify its limited financial markets for savings mobilization and productive credit usage. Also, USAID's world-wide experience in assisting with open entry systems (privatization, competitive environment creation) can be put to good use. USAID/Nepal has already helped to develop Nepali expertise by sending members of the Commission on Privatization and other key GON and business leaders to privatization workshops. Also, a number of studies on the potential for privatization of state enterprises have been funded by USAID. U.S. experience with chambers of commerce, trade associations and training in all aspects of business will serve the project well for strengthening the private sector and complementing policy reform efforts.

These major policy changes in systems, attitudes, and approaches which address the needs of both the government and the private sector, will take years to implement. The programmed time frame of five years is considered adequate to initiate and implement key reforms. Strengthening of the private sector is an unending requirement and policy reforms and adjustments will always be needed.

The Project's two major components, Private Sector Strengthening and Competitive Market Development, encompass five categories of activities. It must be acknowledged that major shifts may be required if new opportunities arise or major constraints cannot be quickly overcome. The new government is presently reviewing economic policies as it works to establish its agenda for national development during the next five years. The Project will be a flexible instrument for helping Nepal to liberalize its economy, not as a rigid program that must be followed for the project to succeed.

Our approach is straightforward, but individual activities may vary considerably from those described herein. USAID will provide the technical knowledge and training needed to convince Nepalis that improvements in policies for the private sector business community are necessary. Changes will be made through an open forum, where all those affected can contribute. A large, constituency, willing to work for policy change, will be nurtured, educated, and strengthened. This can be started, through the project, by identifying people within the decision-making hierarchy who are open to change and then by demonstrating to them the benefits of key policy changes. Each such benefit will be directed towards Nepal's own specific needs and circumstances. The ingredients necessary for a successful project are the identification of leaders ready for change, strengthening their understanding of the need for change, building a constituency for appropriate change, and the presence of a business community ready and capable of using new opportunities for economic growth and equity.

Determination of which activities to implement first must be well thought out. As a simple guide to selection, the following questions should be raised and answered positively.

1. Will the activity lead to economic growth and equity?

2. Is the time frame for achievement reasonable and within the life of the project?

3. Are there sufficient resources, financial and technical, to accomplish the task?

4. Is the activity "politically" acceptable and feasible, is there a reasonable level of receptivity amongst decision-makers?

5. Is the sponsoring organization for an activity capable and committed?

6. Does the activity fit within the Mission's overall strategy? Is it complementary to the Mission's and other donors' work?

Most activities will be centered around organizations which speak for and strengthen business enterprises in Nepal. The business strengthening activities will be implemented through a Business Development Steering Committee composed of representatives from the Federation of Nepalese Chambers of Commerce and Industry (FNCCI) and the Nepal Chamber of Commerce (NCC), USAID, and the Joint Secretary of the Ministry of Industry (MOI). It is generally recognized that the FNCCI represents larger, more established, firms. NCC, a major member of the FNCCI, represents middle-sized firms in the Kathmandu Valley. Members of the academic community and consultants will be included, as they are often more objective and are able to analyze the benefits of change. Leadership must come from Nepalis, with the role of outsiders strictly as supporters of Nepali efforts.

All policy-oriented activities will be implemented through a Policy Dialogue Streering Committee composed of senior economic advisors from the Ministry of Finance (MOF), National Planning Commission (NPC), the MOI, Nepal Rastra Bank (NRB), and USAID. Other government officials will be added to this committee as appropriate for given topics. The Policy Dialogue Steering Committee will also have representatives from business groups. Others from academia, consulting organizations, NGOs or labor, may be added to the steering committee. The USAID project officer will work as a member of both committees, helping to select and develop an implementable agenda of activities.

Once policy areas are identified, project personnel will work with key decision-makers in those areas. These individuals will generally be senior technical officers, planners, and operational personnel (rather than politicians and owners). For the policy dialgue process to be effective, it must go beyond simple provision of information to decision-makers. By involving local consultants, business people, and senior government officials, and by using such tools as seminars, the media (press and radio), and training courses, the constituency for change can be expanded and strengthened.

C. Project Components

The project components have been grouped into two inter-related activity areas. Through a program of private sector strengthening and development of competitive markets, the Economic Liberalization Project will make a major contribution to a better business climate and will help expand economic potential within Nepal.

1. Private Sector Strengthening

Activities outlined under this component will encourage the growth of private enterprise principles and support organizations contributing to democratic development and access to opportunity. Specifically, this component will:

- promote business participation in democratic, political, and policy formulation processes to enhance the private sector's role in national economic growth (Local Institutions);

- increase the base of commercial and managerial expertise and strengthen independent business organizations (Business Skill Training); and

- encourage growth of exports through both technical information and new technologies (Trade Support).

The following is a description of each area, including problem identification, suggested activities, inputs, and potential outputs.

a. Local Institutions

i. Problem Identification

A variety of intermediary institutions currently serve the Nepali private sector. Trading companies, business advisory services, district chambers of commerce, trade associations, and labor groups, all exist with varying capacities. Of these intermediaries, trade associations, district chambers of commerce, and the FNCCI appear to be the most active in supporting the private sector. The FNCCI also serves as an "apex" body interacting with the GON on behalf of other intermediaries. Periodically, the FNCCI chairs meetings to discuss with chambers and associations important problems facing the private sector, and exchanges information on trade inquiries, international seminars, conferences, and trade fairs.

Although these meetings provide a useful forum for discussing government policies, regulations, and labor issues, there appears to be little follow-up with the GON to resolve problems. Past delays in response and untimely GON policy decisions have resulted in loss of international business. For example, an international demand for silver jewelry was unmet because the GON could not reach a timely decision on export policy. When policy decisions were eventually made, the market had declined, resulting in a lost opportunity for exporters.

This lack of GON/private sector coordination is compounded by the seemingly arbitrary way the GON views the private sector. In principle, the GON gives these organizations importance and weight, but in practice, they are not given due recognition. One key area where the GON does support the FNCCI, chambers and associations is in giving them authority to issue Certificates of Origin on exported products. These groups are dependent on revenue derived from this service to offset much of their operational expenses.

Apart from the governmental relations role, FNCCI, district chambers and associations serve their membership by passing along trade information and technology-sourcing opportunities, organizing training courses, sponsoring in-country trade fairs, and buyers trips.

Given the role that FNCCI, chambers, and trade associations could play in liberalizing Nepal's economy, there is an urgent need to strengthen these institutions. However, because several donors, including USAID (through ATSP), are currently assisting FNCCI in strengthening its internal management and lobbying capabilities, the institutional strengthening activities outlined under this component will focus on district chambers, and associations. The following describes each type of organization and what activities might be sponsored by USAID to strengthen services provided to the private sector.

District Chambers of Commerce

Similar to their U.S. counterparts, district chambers of commerce act on behalf of businesses within their locality and provide a forum for members to discuss issues, plans, and problems. All chambers are government registered and have legal status. On the average, membership from the trade sector outnumbers the industrial sector. Members from industrial sectors are mostly from small- and medium-scale industries. Large attendance at general assembly and executive committee meetings indicates that members are genuinely interested in their chambers' activities.

The main expenditures of chambers are for personnel and office expenses. Some chambers own their office buildings, while others have barely adequate office space and equipment. Paid administrative staff conduct day-to-day activities, while planning and budgeting activities are done by an executive committee. Sub-committees are formed as needed in response to pressing problems or issues. The main income sources of chambers are membership fees, service charges for issuing Certificates of Origin, and fees for writing letters of recommendation on behalf of companies interested in foreign trade.

Some of the internal management problems common to chambers are:

- no professional staff to plan and execute a wide range of services and programs, such as business management training and legal consultancy, improved press relations, and research and development programs;
- insufficient office equipment to facilitate services and information dissemination;
- inadequate libraries;
- limited awareness among executive members about the importance and means of conducting fundraising and membership drives to expand coverage and to increase revenues; and
- lack of appropriate training to strengthen internal management of chambers.

Also serious external problems exist, including little active cooperation from the GON, inadequate coordination with trade associations and FNCCI, little active response to government policies, and lack of recognition from the GON and other organizations.

Trade Associations

Twenty-six trade associations are known to exist in Nepal. Their principle functions include: resolving technical/business issues raised by members, providing suggestions and comments on policies to the GON, mediating between entrepreneurs and labor/trade unions, and sharing trade information. On the whole, interaction and cooperation among associations are weaker than among chambers, as each association represents a different product/commodity and normally does not consult with others.

Most industries are represented by associations, with small- and medium-scale industries outnumbering cottage-scale industries. All associations have an executive committee that manages the association. Unlike chambers, the number of paid staff is negligible. The majority of executive committee members are from larger businesses and often find it difficult to balance the needs of the association against those of their own businesses. As a result, current services to members are minimal. Planning is conducted on an ad hoc basis with sub-committees formed to perform selected tasks. Income sources are limited to membership dues and fees from issuing Certificates of Origin which barely cover basic office expenses.

The most common problems of associations are; weak organizational structure, minimal coordination with the GON, limited financial resources, lack of adequate office set-up, limited information dissemination systems, and small professional personnel.

ii. Description

A thoughtful plan for providing technical assistance, training and equipment is needed to address the problems identified. The following illustrates an approach that could be taken.

1. Identify Chambers and Trade Associations

Initially, the Project will select a number of trade associations and district chambers of commerce with which to work. Selection criteria might include:
- recognition by the executive committee that current functions can be usefully strengthened to better serve the organization and its members;
- membership interest in acquiring and financially supporting more services;
- historical organizational achievements and a clear vision of the future;
- degree of interaction with other organizations and the GON;
- sound financial status; and
- adequate physical facilities to work from.

An initial examination of chambers revealed that the Nepal and the Lalitpur District Chambers of Commerce may satisfy the above criteria. Should these chambers be chosen first, later on care will be taken to select others from beyond the Kathmandu Valley for greater geographical representation.

The selection of trade associations for USAID support will also be based on the above criteria, as well as the sector's relative importance to the national economy. For example, tourism, carpets, and handicrafts/silver working are key sectors. Care will be taken to provide support which will assist the entire private sector by working with labor groups who have a broad perspective on the importance of business for Nepal's economic development.

2. Needs Assessment and Implementation Plan

An assessment of members and staffs' needs regarding services, training, and technical information is critical to planning effective organizational strengthening efforts. Once needs are identified, an implementation plan is necessary to determine the human and financial resources required and schedule of activities to be carried out.

The needs assessment will accurately define the needs of the institution and its membership in the most pragmatic sense. Examination of the level of current services provided to the membership and the staff's opinion of these services are important inputs, as is an understanding of what new services might be offered and what the demand is for these new services. Such services might include the following.

(a) Information Sharing - Chambers and Associations play a critical role in passing along information from a number of different sources (i.e., trade journals, technical quarterlies, etc.) to members. Not all chambers and associations have a trade library. For those that do, few members use the library because of competing time pressures and the inadequacy of the collection. In addition to underutilization, some libraries have experienced pilferage problems. Institutional strengthening activities could include purchasing a copying machine to deter pilferage and efforts to upgrade the skills of the staff "librarian" to synthesize articles to be included in newsletters. Announcements of new journals, summaries of technical articles, and trade show information can be transmitted through newsletters. Additionally, library collections/subscriptions need to be organized and upgraded to include international publications germane to sectoral needs. Chambers and associations must have wider international contacts.

(b) Improved Press Relations - There is a need to develop the capacity of the chambers and associations to interact more effectively with the media. Establishing an on-going dialogue and an improved relationship will permit the private sector to publicly express opinions on government actions and to publicize success stories in export company start-ups and expansions, etc. Such success stories will help improve the negative image that the business community has with both the press and the public.

(c) Policy/Legislative Advisory Services - An advisory service to Parliament could create a convenient channel for private sector participation and can help inform the public on the political process and can improve implementation of action plans on key advocacy issues (regulations, informal sector, privatization, business-labor laws, etc.) Operationally, a staff person would be housed in either a chamber or association (perhaps the Nepal Chamber) to support the work of the Policy Steering Committee. This role is explored fully in Section III C 2 a.

(d) Office Automation - No association or chamber has computerized its internal management functions (i.e., membership directory, mailing list, etc.). These activities are being done by manually, occupying valuable staff time and resources. A personal computer, fax machine and copying machine would be usefull additions for larger representative groups and enhance their ability to serve members.

(e) Fundraising Activities and Membership Drives - It is necessary to educate members and staff of the need to charge for certain services currently provided free in order to generate revenue and to expand the number of services offered.

The minimal services now provided are largely financed by the revenue generated by issuing Certificates of Origin or from membership dues (which are very low). Without additional sources of revenue, both chambers and associations have not been able to meet members' demands for services. Membership drives can be organized to expand the revenue base. Also, as new and expanded services are introduced, fees can be charged to offset costs.

The above are illustrative of the kinds of activities that can be conducted. The training needs assessment would identify which courses/services are desirable, and in what priority order. Once services, training and equipment needs are identified, a training plan can be designed, laying out sequencing, target audiences, and human and financial resource requirements.

iii. Inputs

The Project will provide short-term technical assistance to carry out these tasks. Where possible, the chambers and associations themselves will assign or hire a staff person to take on as much responsibility as possible to work towards institutional sustainability.

Potential implementors include the Center for International Private Enterprise (CIPE), Institutional Reforms and the Informal Sector (IRIS) Project, and the American Management Association (AMA). Training will be carried out through the contractor, a local firm and the concerned institutions themselves. Commodities will include electronic office equipment, computers, printers, library catalogues, books, and periodical subscriptions.

To optimize sustainability, all planning and implementation activities will be spearheaded by the involved chambers, associations, and labor groups themselves. Any new service that is introduced will be determined by demand coming from the membership. USAID funds and selected technical assistance will be used to support the following activities; assessing needs, procuring appropriate equipment, providing training, and implementing changes in the services that chambers and associations provide to their members. The first three activities can be handled through a short-term technical assistance contract, while the latter activity may require a part-time resident advisor to help implement changes.

iv. Results

Provision of a small amount of technical assistance and equipment to chambers and associations should lead to changes in the way they share information with members, interact with the press, influence government policy, and manage their internal operations. There is considerable potential for a demonstration effect extending to chambers and associations not directly participating in this Project. This effect could be helped by encouraging establishment of "sister chamber" relationships between strengthened chambers and others. Also, sister association/chamber relationships can be forged with U.S. counterparts from locations important to Nepali exports. Training for all groups will increase their abilities to represent their membership and to provide the membership with better information and support.

By the end of the project, at least two trade asociations and two district chambers of commerce will be capable of providing substantially expanded services to members. Each will have an established library that contains essential sectoral information, data, journals, and texts available to members. Each organization will be capable of hosting training, conducting policy dialogue and advocacy on issues of importance to members, and representing the interests of the group on a local and national level. The organizations will be financially viable without requiring outside support.

b. Business Skill Training

i. Problem Identification

Despite their current limited numbers and contribution to GDP, service and manufacturing industries are expected to be increasingly important sources of employment and national income. Yet rapid growth in these sectors of the economy is being constrained by a paucity of management and marketing expertise in several important areas. Heretofore, Nepali businesses have been left to grow on their own, in ways that may not be particularly effective or efficient.

The root cause of scarce management expertise seems to be a lack of business and technical skills training targeted at the private sector. Few technical training institutions and even fewer management training institutions exist in the country. There are a few public institutions designed to meet management training needs of the public sector. Past training efforts are viewed by the private sector as too theoretical and lacking client-oriented approaches for meeting practical needs. Presently, most businesses rely on ad hoc, on-the-job training, or in some cases, on sending staff abroad for training.

Only recently, a handful of public and private sector institutions, projects, and associations have turned their attention to the training needs of the private sector. In 1987 a jointly sponsored USAID/GTZ study of nearly two dozen Nepali training institutions found that relevant management training does exist for the public sector but institutions engaged in private sector training were perceived as ineffective and lacking in credibility. One notable exception is the GTZ-funded Small Business Promotion Project (SBPP) that works with microentrepreneurs and small and cottage industries.

Success in creating effective, sustainable training programs will depend largely on the active technical and financial participation of the private sector from the start. Establishing a training program could be undertaken on a cost-sharing basis with businesses pledging financial support via an endowment fund or patron system. The scope and breadth of any course needs to be identified in consultation with the private sector target audience and offered on a tuition payment basis. Technical and cost-sharing components will force businesses to take a hard look at their internal training needs.

In addition to cost, other key considerations include timing, location and staffing of courses. Based on initial feedback from businesses, nondegree, highly focused 1-2 week training courses, offered for a few hours in the evening, are optimal. To serve a broader geographic audience, training courses could be rotated around the country. A possible vehicle might be to focus training efforts through district chambers of commerce, with the NCC serving as a base of operations. The NCC offers adequate, centrally-located facilities in a neutral setting.

ii. Description

A variety of training activities will be undertaken which will address certain needs of the business community. First, a Training Needs Assessment will be conducted to determine specific needs of private sector businesses, the degree of private sector support/necessary for establishing and financing a training program, and sources of local, regional and U.S. expertise that could be effectively mobilized to meet the training needs of the private sector.

Meetings will be arranged with other donors, local chambers, trade associations, business support organizations, banks that lend to businesses, and Nepali management training institutions to identify needs. Foreign donors working with the private sector include: the ILO and Norwegian through assistance to the Institute of Management at Tribhuvan University; the UNDP/World Bank and GTZ through assistance to training small and cottage-level entrepreneurs; the ILO/UNDP through assistance for tourism training and FNCCI institutional strengthening; and the proposed GTZ assistance through chambers and trade associations serving small businesses.

Tentatively, training programs are envisioned in the areas of management, finance, accounting, production, personnel, public relations and financial instrument development. Short-term training, both regional and local, will be conducted by outside or local experts. Roughly 325 person-months are envisioned through short courses (see Annex F).

iii. Inputs

In-country training is preferred to regional and U.S.-based training because of costs, logistics, and importantly, cultural advantages. However, U.S. or regional sites will be considered for specialized training where exposure to the U.S. or Asian business/trade environment, institutions, and methodologies would greatly improve the quality.

Specialized expertise is required to help the private sector and organizations serving the private sector assess training needs and identify trainers. For sustainability, training of trainers will be carried out by existing Nepali management institutions, whenever possible. Wherever a training program is initially located, a staff person from that organization should be dedicated to the effort. This individual can help plan and implement training activities. Once a "track record" is established, the course can be transferred to an existing training institution to optimize chances for sustainability. Efforts will be made to make training available to a broad, representative group, with special efforts made to include women and minority groups.

iv. Results

Immediate beneficiaries will be individuals who receive business skill training and thereby improve their technical and management capacities. Secondary beneficiaries will be businesses which gain from better trained employees, leading to increases in productivity and earnings. The ultimate beneficiary will be Nepal's national economy, through increases in services, employment and revenues generated by a better functioning private sector.

By Project completion, the Nepali business community will be better able to meet the challenges and opportunities of a dynamic economy with an estimated 340 person months of local training and 52 person months of U.S. and regional training. The capability to host and organize targeted training programs will be institutionalized by the end of the Project (within at least two associations and two district chambers). The business community will be capable of identifying organizations and skilled individuals who can provide training needed within the Nepali business community.

c. Trade Support

Activities supported under this section promote the growth of key sectors of Nepal's economy and complement the work described earlier under Local Institutional Strengthening. In general, activities outlined below provide trade and technology services which optimize the success of key sectors.

The following describes how the carpet, handicraft/giftware and tourism industries can be supported.

i. Problem Identification

In the past, Nepali producers have been successful in penetrating export markets for carpets, silver jewelry, and selected handicrafts. These successes have been achieved in the face of fairly severe constraints including high transport costs, a poor policy environment, and difficulties faced by producers in understanding export market requirements. In spite of these problems, opportunities exist for Nepali producers to diversify their product lines and build upon available skills and resources.

Without a carefully directed program designed to overcome the difficulties producers face in identifying market requirements, acquiring production know-how, or dealing with unsupportive policies and regulations, international buyers are likely to bypass Nepal in favor of producers better positioned to meet their requirements.

Initial market research has identified several areas in the home products industry that may offer opportunities for Nepali producers to improve product lines and diversify exports. The home products industry is a natural link to the carpet and handicrafts area. Home products buyers are constantly in search of new and unusual products (lamps, lamp shades, picture frames, mirrors, wall hangings, artwork, and other accessories). Also silver jewelry and silver table top accessories are high-value products consistently in demand. Carpets and complementary items such as decorative pillows, placemats, and napkins offer additional opportunities. Within these industries it is possible to identify a number of products that are relatively high-value, light-weight, and skill-intensive. Furthermore, it is possible to attract individual buyers that are interested in developing new sources of products utilizing unique materials and skills.

An additional feature of the home products industry is that it includes firms able to produce new products in varying volumes, ranging from very small quantities for boutique outlets up to high volumes for mass merchandisers. Moreover, firms in this industry use components for assembly rather than strictly finished goods, since handicraft producers often face limited long-term, extended markets for local handicrafts. Often, components in end products can have a higher, long-range demand.

Tourism Industry

Nepal is known for its natural beauty. Although the tourism industry is one of the leading sources of foreign exchange earnings in Nepal, only the international adventure and trekking segment (representing a relatively small market niche) has been developed.

Growing competition among the world's destinations presents a continuing challenge to maintain or increase market share and requires provision of ever improving, good value vacation experiences. Nepal faces several challenges in the very competitive tourist industry because of:

- limited international access by air;
- insufficient tourism facilities and transportation for meeting international standards of comfort, sanitation and aesthetic satisfaction;
- few tourism and travel-related professional services and industries; and
- lack of knowledge about regional and other tourism markets and distribution channels.

ii. <u>Description</u>

Project activities can be addressed in the following areas for carpets and giftware industries through efforts to:

- Provide assistance in identifying specific market opportunities for Nepali producers that build upon available materials, resources, and skills;
- Select high potential suppliers to serve as lead procurers in establishing new export lines;
- Provide technical assistance in design, production, techniques, materials utilization, costing, packaging, and quality control to enable producers to meet buyers' requirements for specific orders. This may entail bringing in experienced designers/product developers and buyers to work with lead producers in developing new export lines;
- Arrange initial market introductions of new products through appropriate trade shows;
- Identify additional producers to be trained in manufacturing specific products or components in order to expand the supply of export-capable producers to meet larger orders. Locate needed technologies to increase output capacity to fill larger orders;
- Provide support to industry associations to improve their capabilities in supplying market information, production assistance, other services to their members;
- Identify firms able to provide marketing and trading services on a continuing basis;
- Develop incentive packages to stimulate improved commercial services and overcome start-up problems associated with establishing new export marketing relationships; and
- Link management training courses described under II, Business Development Skill Training, to the identified needs of new or expanding export firms.

To effectively market Nepal tourism in the U.S. the following activities can be considered:

- Systematically evaluate U.S. market demand, strategic planning needs and options for overcoming current obstacles to tourism promotion in the U.S.;
- Target assistance programs to trade associations (trekking operators, travel agents, and hotels) involved in the tourism industry; and
- Promote participation of public and private sector in tourism

planning, marketing and development of promotional projects aimed at the U.S. market.

iii. Inputs

For both home products and tourism industries, contractor support will be needed for implementation. There are several possible sources for assistance, including retired, volunteer executive programs and centrally-funded AID projects. Roughly two person months of external assistance per year is envisioned. Training is estimated at a total of 140 person months over the life of the project.

iv. Results

Combined U.S. and regional training for 60 person months and local training for 80 person months in targeted courses and study tours is estimated. Activities conducted under this section will provide key services to assist in building Nepal's economy. The targeted sectors will have a much better grasp of external market demands and requirements, pricing considerations, and ways/places of getting assistance for growth and funding. The supported associations and chambers will be able to identify opportunities for expanding products and markets and for increasing revenues.

2. Competitive Market Development

In working towards the purpose of defining and implementing government policies that support a pro-market, private sector-led economy, the essential ingredient is an environment which is open, equitable, and clearly understood by the business community. The development of such an environment is only possible where there is no favoritism in establishing and operating business enterprises, where access to capital and needed skills training is readily available and where rules and taxes are reasonable and systematic. The Government of Nepal needs to establish just such an environment and numerous policies need to be instituted or reformed to lay the basis for a productive, prosperous economy. Through continual policy dialogue with the principal leaders who determine policies, including members of parliament, ministry officials, business community leaders, and business owners, changes in the business environment can be made. This component aims at facilitating the process of change and at providing decision makers with the information needed to make the most appropriate choices for economic growth and equity in Nepal. This component of the project has been divided into two activities, Regulatory Environment and Open Entry System.

a. Regulatory Environment

i. Problem Identification

Private sector activity in Nepal is hampered by complex and burdensome regulations, ineffective and uneven administration of regulations and a lack of private sector participation in policy formulation. The result is that many individuals opt out of the formal business sector, with costs to themselves and to development of Nepal. Firms which do participate in the formal economy are saddled with unnecessary costs and unreasonable delays, limiting their competitive ability.

The GON's performance in shaping the business environment has often retarded growth, reduced private sector employment and income, and prevented healthy competition. This negative influence on private sector activity begins at the very start of a business' existence. Preliminary research on the process of enterprise registration in Nepal suggests that the costs of formal participation in the economy are often prohibitive. The average length of time required for an entrepreneur to prepare legal documents for registration is 141 days, at a cost of Rs.347,000 ($9,900); processing the application itself requires 153 days and costs Rs.9,000 (excluding transportation outlays, bribes, etc.). Consequently, the opportunity costs imposed by the formal regulatory environment for business enterprises are very high.

Firms which opt out of the formal economy are beset by another set of difficulties. Small, unregistered firms do not enjoy economies of scale. Significant technological innovation is unlikely since small firms cannot absorb state-of-the-art methods. Wages and family incomes are typically low among unregistered, informal enterprises. The scope for human capital creation is constrained. Time and energy are wasted in avoiding detection or escaping harassment. Labor and health conditions in the sector are often deplorable. Even macroeconomic policy interventions such as fiscal policy adjustment or money supply and interest rate management, are subverted because they have little impact on the demand and monetary flows of the large number of enterprises in the informal sector.

Even if a firm overcomes the hurdle of registration, the regulatory environment in Nepal hampers the ability of registered firms to grow and compete in domestic and international markets. When government allows businesses to respond freely, there can be large gains for both firms and the economy. For example, relaxation of import licensing of inputs for the carpet industry led to dramatic gains benefitting existing and new carpet firms, jobs for thousands of employees, and hard currency earnings for Nepal. Other sectors of the economy would benefit from comparable regulatory forbearance.

Regulatory oversight in establishment of new lines of business, import of new technology (through hard currency limits) and arbitrary administration of taxes all limit the ability of private firms to grow. The requirement that firms re-register annually adds additional costs. The consequence of these often unnecessary requirements is that firms, while remaining registered, conduct many transactions informally. This non-compliance breeds a lack of confidence in all government institutions and widespread disregard for those regulations. By over-regulating, the GON reduces its credibility in areas of needed government involvement. The private sector response to this is rational, but makes it easier for public sector detractors to describe the private sector as lawbreakers and profiteers.

Regulations are determined by various government ministries and departments, by parliament, and, formerly by the Palace. The ineffectiveness of the judicial system leaves individuals with little opportunity to challenge arbitrary government actions. In short, a whole range of institutional arrangements are functioning poorly. Government decisions do not reflect a consistent approach to the private sector and are often contradictory. An Industrial Promotion Scheme gets mired in ministerial efforts to second-guess the investment plans of those who might take advantage of the law. An export tax on cement may lead to a fall in output and to a diversion of sales into smuggling outlets for India. Steep license fees on raw-materials imported for cottage industries may lead them to opt out of registration and expose them to extortion. The difficulties in the regulatory environment are of two general types:

- The substantive provisions of regulations are generally burdensome, stifle competition and are often seem designed to encourage ambiguity and corruption.

- The current process for determining policies does not include economic analyses of proposed policies and rarely includes participation by affected interests.

Specific areas of regulatory difficulty in Nepal include:

1. Licensing and Permits
2. Taxation and Reporting
3. Pricing
4. Foreign Exchange
5. Capital Access
6. Labor Practices
7. Environmental Control
8. Incentive Programs

These categories constitute a daunting set of institutional constraints to an efficient private sector and discourage enterprises from functioning as formal entities. Actions to address several of these categories - labor practices, environmental control, incentive programs - are being funded and coordinated by other donors in close collaboration with USAID. Yet, there remains a whole panoply of regulatory impediments to an efficient private sector that have not received adequate attention. The following are considered priority areas.

Licensing and Permits

It is a hallmark of a productive economy to have fast, efficient procedures for registering a business. Registration typically enables firms to enjoy access to courts, limited personal liability for owners, access to credit and the benefit of other legal institutions which secure property rights. However, in Nepal registration of a firm does not guarantee legal protection (judicial mechanisms are ineffective). Registration imposes considerable costs and exposes firms to taxes and other liabilities.

Procedures for obtaining licenses and permits are cumbersome and often contradictory. Numerous case studies demonstrate the high costs of formal registration procedures and consequent losses to the entrepreneur and the economy at large. Improving business registration procedures would be a straightforward means of strengthening the private sector.

Major bureaucratic problems exist for firms required to comply with GON licensing and permit procedures. By way of illustration, it is a prerequisite that any individual wishing to establish a small or medium size industry must present an industrial scheme and feasibility study to the Ministries of Commerce and Industry. It would be much more efficient and to the point for the lending institution and the borrower to be responsible for assessing the associated risk of an activity. It should not be the government's role to evaluate or second-guess the soundness of entrepreneurial initiatives.

The government does have a legitimate right to information with respect to the activities, gains, and losses of firms for purposes of monitoring, taxing, etc. Government authority should be clearly delineated, however, to minimize controls and administrative processes.

Taxation and Reporting

One important function of any government is to collect revenue. However, the means by which governments collect revenue vary greatly. Typically, in developed economies taxes are collected on the basis of a uniform set of clear criteria applied to all enterprises. In Nepal, taxes are not applied uniformly and are often arbitrarily assessed at the discretion of the tax collector. For example, annual income taxes are often adjusted at arbitrarily-set, annual rate increases regardless of whether an enterprise has profited or suffered losses. This encourages tax fraud and evasion. High retroactive income taxes are levied (often arbitrarily) on past, unaccounted for incomes of individuals when they newly register businesses. This creates disincentives to registration with consequent forfeiture of government revenues.

Pricing

The GON attempts to regulate many prices in the economy at both wholesale and retail levels. The subsequent distortions are both predictable and widespread. Examples are numerous, the most recent being the establishment of a low price ceiling on refined sugar that resulted in large amounts of sugar being smuggled to northern India and consequent shortages in Nepal. If the GON does not deregulate prices, as is being done in most other countries making the transition to a market economy, imbalances and shortages will continue.

Foreign Exchange and Capital Access

Goods, labor, and capital presently move freely between Nepal and India. Both countries have recently devalued their currencies to promote exports. Previously, foreign exchange was allocated according to administrative discretion instead of market principles and resources were expended for non-productive purposes. Efforts are being made by the GON to change this situation.

Until recently, foreign exchange controls made it difficult for Nepalese entrepreneurs to obtain hard currencies needed to finance imports of materials from third countries or to engage in international trade. Realizing that a long time was spent to obtain import licenses, the GON recently announced the elimination of import licenses for industries that use less than 50% imported raw materials.

Advocacy by private sector groups to improve these policies is limited by several factors.

1. There is a widely held attitude in government that private sector advocates cannot legitimately argue for a particular policy which might benefit themselves, or that officials who promote a policy which favors the private sector must be corrupt.

2. The newly emerging democratic government lacks clear access points or mechanisms which would permit democratization of the policy formulation process.

3. Existing interest groups have succeeded in the past only by convincing individual officials to make narrow provision for a small number of firms. The lack of general standards for the adoption and implementation of policies has the result that firms and their associations tend to simply take the most expedient action, solving immediate specific problems, and not focusing on broad policy issues.

ii. Description

These are the basic targets of regulatory reform:

1. Elimination of steps/forms required for registration, licensing, permits;

2. Simplification and rationalization of regulatory standards to enhance the predictability and speed of regulatory decisions;

3. Strengthening of public and private sector capacity to apply economic analyses to the consideration of policies;

4. Simplification and clarification of basic business legal regimes and legal processes; and

5. Encouragement of public education and information dissemination on the regulatory environment and related individual/organizational rights.

Regulations to be targeted will be determined through the interest and support shown by the Nepali private sector and by opportunities which occur in the course of the GON's own work on policy reform. Many possible reforms are described in the IRIS report "Promoting Entrepreneurship: Output for Reform", attached as Annex G.

To establish a regulatory system which meets the purposes described above, a basic, sound approach and systematic procedures need to be established. The following steps summarize the means by which this project will be organized. Firstly, all pertinent regulations will be collected from all sectors of the GON. They will be grouped by category and type (and translated if necessary). The next step will be to analyze all regulations within a given category and type (as shown in the section above, Problem Identification). Then the analysis of the regulations will be used to determine options for changes, additions, deletions, and new regulations which best fit the need to simplify and speed up regulatory decisions and enhance equitable economic progress. The next crucial step is to instigate adoption by the GON of the changed regulations. The following step is to institute the implementation and application of these regulations. Lastly, the impact of the regulatory change is to be measured.

1. Collection, Collation and Simplification

Through business groups and associations, key regulatory bottlenecks have already been identified. The top priority for reform are regulations for licensing and permits. Extant regulations can be collected from the concerned government institutions (Ministries of Finance, Commerce, Industry, Home, and Labor and Social Welfare). Once all documents are collected, they will be collated and summarized/simplified for clear understanding. It may be necessary to translate them into English. They will then be ready for analysis.

2. Analysis

The selected category of regulations will then be studied to determine consistency and contradictions and to determine their probable effect on business, consumers, the environment, and GON. Regulations will be reviewed in comparison with equivalent regulations from other countries. Conclusions will be drawn about the overall effectiveness of the regulations.

3. Revision and Creation

Using completed analyses of a given category of regulations, changes in existing regulations or design of new regulations will be drafted. Drafted regulations will aim to promote growth, income, employment, and competition. They must balance these aims with protection for the consumer and environment, with the GON's need for tax revenue (if applicable), and with the effect on the national economic and financial situations. A series of options for changes will then be developed.

4. Adoption and Legislation

Once draft regulations in a given category have been recommended, it will be necessary to convince key decision-makers that the changes are needed and justifiable. Parliamentary representatives, senior civil servants and business leaders/groups must be presented with cogent reasons to reform the regulations and be enlisted as advocates for promoting the necessary changes. They will need to be convinced of both social and economic benefits of the changes. The general populace should also be presented with arguments for reform, clear presentation on benefits of change, and their support will be sought. To mobilize the support for change in key regulations, a variety of actions will be considered. These include open meetings and seminars, publication of articles, direct lobbying by interested groups and individuals.

5. Operations and Implementation

To institute and implement regulatory change, officials responsible for applying and enforcing the selected category of regulations will need to be trained in application of the changed regulations, the benefits of the changes, and the means by which these regulations can be carried out. Formal classes for GON officials, including customs officers, tax assessors, GAO staff, and municipal employees, will be conducted. The texts of regulations will be printed and made available to all concerned segments of the population.

6. Measurement of Change

To the extent possible, initial data will be collected on costs, time, and revenues collected under existing rules and regulations. With this baseline information, the impacts of new rules and regulations can be measured. New cost and revenue, time requirements, and operational effects on the business sector will be gathered and the benefits will be illustrated.

The length of time required for performing these steps is dependent on many factors. The complexity and scope of the category of regulations will make each step a time consuming process. It is preferable at the beginning of the Project to choose a relatively narrow set of regulations, where the benefits of change are readily apparent and where the administrative "environment" and political opinion favor change. With an initial success in regulatory reform, additional reforms will be easier and quicker to initiate and implement. Positive learning experiences will help establish a system and the contacts needed to conduct constructive policy reform will have been made.

iii. Inputs

As noted earlier, there are many participants essential to carrying out reform of the regulatory environment. Without the support of key decision-makers, reforms are unlikely. To supply those decision-makers with basic rationale and background information for regulatory change, research, analysis and advocacy/education advocacy support must be provided. The skills needed for research, analysis and advocacy are not well developed in Nepal. It will be necessary to obtain technical assistance from abroad. Preliminary work with Institutional Reforms and the Informal Sector Center (IRIS) has shown that this project has staff who have many of the skills required. Personnel skilled at researching local regulations, analyzing costs and benefits, making comparisons with experiences in other countries, and educating key policy-makers of the benefits of change, are available through IRIS. At this juncture, we plan to execute a buy-in for the provision of IRIS technical assistance to conduct and manage this particular project activity.

IRIS alone will not be able to reform selected categories of the regulatory environment. Essential is the direct and active participation of local business groups, such as chambers of commerce, trade associations and business leaders. Also, government officials and political leaders who have been responsive to the need for regulatory reform must be included in carrying out several steps in the process, mainly in selecting categories of regulations and in education/advocacy with policy makers. The selection process has already begun (Annex G) and similar workshops and seminars will be conducted for both selection of regulation reforms and for the advocacy of those selected reforms.

Four basic training programs will be established as part of this activity. First, local businessmen and groups will be trained through short-term targeted seminars on how to analyze regulations and the impact of change (these may be both local and international). Local expertise, in time, will be available to determine the efficacy of regulatory reform and measure the benefits accrued. Second, seminars will be held to identify crucial problems and possible solutions within the regulatory environment. Major participants are businessmen themselves and concerned GON personnel. Third, both leaders and the public will be educated on the benefits of certain regulatory reforms. The media (radio, newspapers, publications), seminars, and lobbying campaigns will be used to convince and activate key segments of the regulatory system and general populace. Fourth, the actual implementers of the new/changed regulations will need to be trained; they will need to learn the value and benefits of the change and how to apply the regulations in appropriate situations. Formal training courses, probably through GON training institutions with support from outside experts, will be conducted. These training programs will all be supervised, if not actually conducted, by the technical assistance team provided by IRIS or a similar firm with the required expertise.

iv. Results

Institutional reform of the regulatory environment will yield benefits for the Nepalese private sector and the unregistered, informal business sector.

Institutional changes are desirable when they raise the efficiency of resource use within the private sector, enhance productivity, and contribute to the growth of this sector's component in total national product. Particularly at the macroeconomic level such effects may be difficult to separate out from those of fiscal policy, exogenous shocks, or total investment.

The second benefit of institutional reform of the regulatory environment is the reduction of certain burdens on entrepreneurs. Rules that simplify their lives, save time, reduce their exposure to harassment by police and officials do, in and of themselves, improve welfare. These accomplishments will be marked by specific changes in legislation, regulations and enforcement policies adopted by the government following advocacy by Nepali groups. Another mark of accomplishment will be increased understanding of the economics of regulation by both public and private sector individuals. This will be evidenced by their use of economic arguments, preparation of analyses and greater participation in the policy process.

Given the general attitude of many Nepalese toward the private-sector, one important target not easily quantified would be a perceptual change in government as to the role of the private sector in economic development. The discrete project activities, which underscore the importance of the regulatory environment, will initiate awareness among decision makers on the potential of the private sector as a source of employment, innovation, and economic growth. Evidence of this change will come as legislators and ministerial officials clearly support proposals advanced by groups receiving AID assistance.

A third area of accomplishment will be improvements in the policy process - the democratization of regulatory decision-making at both the legislative and administrative levels. These changes can be marked by creation of specific procedures, formally or informally, for the participation of private sector groups in specific policy formulation, and by adoption of government-wide procedures insuring a public right to participate in the adoption of policies and in seeking effective redress for possible maladministration.

Finally, increased understanding of the role of the regulatory environment and institutional framework in relation to private sector-led growth and precise steps for improvement will provide a transferable capability for AID activities outside Nepal.

Highly desirable are verifiable indicators of accomplishment. The lack of currently available baseline data and decisions on which category of regulations to reform makes it virtually impossible to provide "numbers" at this time. However, if registration/licensing/permits-related regulations are improved, certain accomplishments can be expected; increased size and numbers of formal sector businesses; increase in tax revenues from businesses; expanded employment; time savings for establishing businesses and for importing/exporting goods; greater foreign exchange earnings; and greater goods; greater foreign exchange earnings; and greater competition between business enterprises. Once baseline data is gathered (no. of businesses, tax revenues, processing time, no. of employees, etc.), progress can be measured as reforms are enacted and implemented.

All problem regulatory areas will be analyzed as part of this project activity. At least five major policy reform packages will be advocated and promoted with at least partial adoption as new or amended regulations (see Policy Matrix in Section III B).

b. <u>Open Entry System</u>

i. <u>Problem Identification</u>

At present, there are sixty-four public enterprises (PEs) in Nepal. They span the gamut from service companies in various sectors (nine in trad..g, eight in service, seven in social, eight in financial) to pub..c utilities (three companies) to manufacturing firms ...nty-nine companies). No government-owned company has yet bee. privatized. Very few have proved to be financially successful. In FY 1989 public enterprises received 12% of overall disbursements from the GON budget, but showed a negative return on investments. Uniformally, they are considered inefficient, overstaffed and unprofitable.

The GON, however, has not altered this situation, although there has been considerable discussion of the potential to sell certain public firms. Yet the GON has persisted in providing budgetary support, subsidizing prices, providing de facto monopolistic positions, and in maintaining high staff levels. Banks are technically insolvent and do not provide productive credit to businesses or to individuals.

The platforms of the dominant political parties (Nepal Congress and United Marxist-Leninists) both favor publicly owned and controlled enterprises. Yet growing financial constraints and pressure from donor groups may encourage the GON to consider certain options in the structures of these PEs and the environment in which they operate. The recent Budget Address to Parliament sent a clear, positive signal in this regard. Therefore, the Project will continue to promote "privatization", but in forms less threatening and perhaps more desirable to the new government.

ii. Description

In the past, most programs advocating privatization were focused on the transfer of ownership of parastatals from the government to the private sector. While this is still seen as a viable approach to privatization, other options will be explored in the course of the project. These possibilities are listed by their potential of acceptability within the new government.

1. Open Entry System - Free access for the private sector to entry into hitherto somewhat protected sectors, with less protection and increased competition.

2. Management Contracts - Private sector management and GON role reduced strictly to a shareholder role.

3. Employee Owner Program - Gradual increase of equity to the enterprise employees.

4. Equity Sale - A portion of the equity in PEs sold to the private sector.

5. Liquidation - Sale of parastatal assets to the private sector and elimination of the PE.

In the current political environment, the acceptability or implementation of Options 3-5 is seen as remote for the time being. Options 1 and 2 are seen as having a reasonable potential. Option number 1 can initially be approached as an area for regulatory reform, whereby access into sectors closed to the private sector can be made available through elimination of regulatory barriers and of preferential/controlled pricing of inputs and products. The demand for many products and services is much greater than the ability of the public enterprises to supply, especially for such items as agriculture inputs, cement, dairy products, electricity, water petroleum products, transport, and financial services. The lifting of price controls will enhance competition and may enhance the profitability of all enterprises (including state-owned ones). Exploration of this Option will start with an overall examination of registration/licensing/permit regulations which now restrict entry into business sectors. Also, a study of the costs of price controls and input subsidies will be undertaken, for a given sector. A program of establishing an open entry system will then be devised, using the information and analyses performed. Initially, only one sector shall be targeted, where the potential is great and the risks are minimal. Strong consideration will be given to the capital markets sector. If such a program appears to have a high probability of success, an advocacy campaign (through regulatory reform) will be mounted and new business entries provided support.

Assistance for privatization will be linked to the World Bank's Structural Adjustment III Program and complement efforts of the World Bank and IMF. Close communications have already been established. While these multilateral donors concentrate on macro-economic issues and GON institutional capacity, USAID will focus on financing technical assistance and studies in support of privatization.

Under Option 2, the viability of management contracts for PEs that could be made profitable with proper management and control should be explored through an advocacy campaign of a given PE, after a thorough feasibility study has been done. If the campaign is successful and the GON relinquishes managerial control to selected private sector organizations, initial technical assistance support and possible training can be provided to enhance the potential for success. If an initial management contract(s) proves to be successful, further PEs should be analyzed and targeted for private sector management. It is hoped that ultimately the GON would offer its equity in such enterprises to the private sector.

iii. Inputs

Option 1 should not be pursued until thorough feasibility studies are done which show that private sector companies can effectively compete in an open system of a selected business sector. Option 2 should not be pursued either, unless a parastatal firm can be located which will become profitable because of improved management and competition. If these options appear viable, then further activities are warranted. The studies are crucial and should be conducted by a firm well experienced in developing countries and with PEs. There are several world-wide projects and firms which have the staff and requisite skills.

After the studies are performed, regulatory changes needed to open access can be included in the regulatory reform activities described in Section III C. 2 a. above and probably carried out by IRIS. New private sector entries can be supported with industry specific training, perhaps provided by retired executive volunteers or a similar type of U.S. organization.

Under Option 2, when a PE is identified and a management contract sought, USAID may assist the PE in preparation for a management takeover with technical assistance and training provided by a U.S. contractor.

If and when a pattern of success is established for either or both of these options, it may not be necessary for the project to provide technical assistance or training. This depends on the business sector and skill requirements for subsequent efforts and their availability locally.

iv. Results

As the results are highly dependent on many factors, starting with the essential requirements of solid, positive feasibility studies, it is extremely difficult to make predictions on results at this time. We expect to increase private sector business entries into the economy, as noted in the previous section. The magnitude cannot be estimated at this time. It is expected that at least two management contracts can be established with PEs through the project, but this is dependent on the new government's willingness to relinquish control and to provide attractive terms for such contracts. It is also expected that two or more productive areas, previously "monopolized" by the GON, will be opened to free and fair competition.

It is hoped that that the open market system for competition and access will become a guiding policy of the GON. Hitherto closed sectors, such as cement manufacture, large-scale electricity production, petrol product marketing, may be competitive business arenas. Expectations will be reexamined periodically, as part of project reviews and evaluations.

D. Resource Requirements

As was noted under the Project Components - Inputs (for each activity), the principal resource requirements are for technical assistance (expatriate and local), training, and a limited amount of commodities. Since the development and expansion of any given activity should be viewed relatively flexibly, it is essential that the budget also be a flexible instrument and maintain its illustrative nature at this stage of the project. By the end of FY92 or early in FY93, it will be more plausible to create a detailed budget and budget revisions should be made at that time accordingly. The budget is organized by project component, showing the following key line items (with sub-headings) only; (1) Technical Assistance, (2) Studies and Analyses, (3) Training (4) Commodities, (5) Evaluations, (6) Audit, (7) Contingency and Inflation.

As the GON is not expected to play a substantial financial role in the project, only the AID budget is shown. A waiver from the 25% local contribution requirement will be requested, for the reasons stated in Section V E and Annex D. It is unrealistic to budget GON and private sector participation in the project for many activities, as it is virtually impossible (and would be prohibitively expensive) to monitor and document accurately. Reference to Annex C will acquaint one with the basic assumptions used for calculating particular costs. Assumptions were drawn, in large part, from the experiences in other USAID/Nepal projects and related costs. Lump sum figures are used for most line items (as travel, overhead, per diem, communications and incidentals are all incorporated into a single figure per month for technical assistance), except as specified. Evaluations, audit, contingency and inflation are shown for the entire project and not by activity.

Economic Liberalization (367-0161)

Summary of Resource Requirements, in $,000's

	ITEM/CATEGORY	FY91	FY92	FY93	FY94	FY95	FY96	TOTAL
I.	PRIVATE SECTOR STRENGTHENING							
A.	Technical Assistance	-	160	160	160	160	-	640
	Local Support	-	22	22	22	22	16	104
B.	Analyses/Studies	190	30	30	90	30	-	370
C.	Training (Overseas)	-	204	165	222	183	-	774
	Training (Local)		127.5	127.5	127.5	127.5	-	510
D.	Commodities	-	52	4	56	8	8	128
II.	COMPETITIVE MARKET DEVELOPMENT							
A.	Technical Assistance	-	180	180	180	180	-	720
	Local Support	-	23	23	23	23	23	115
B.	Analyses/Studies	50	54	54	54	54	-	266
C.	Training (Overseas)	-	26	26	26	26	-	104
	Training (Local)	-	80	80	65	65		290
D.	Commodities	-	25	-	-	-	-	25
III.	MISSION ADMINISTRATIVE SUPPORT	22	88	88	88	88	44	418
IV.	EVALUATIONS	-	-	66	-	66	-	132
V.	AUDIT	-	-	-	-	50	-	50
VI.	INFLATION AND CONTINGENCY	-	-	51	111	172	20	354
	PROJECT TOTAL	262	1,071.5	1,076.5	1,224.5	1,254.5	111	5,000

Local currency costs of the project are estimated as a percentage of certain costs shown. For technical assistance, the per diem costs and some miscellaneous expenses can be considered local costs. Fifteen percent of the total overseas TA administrative support totals $204,000. All local support costs ($219,000) are considered local currency costs. Costs of analyses and studies are estimated to be 25% in local currency or $159,000. Local training costs are perhaps 75% local currency or $600,000. Commodities are perhaps 25% local currency usage or $38,000. Evaluations and audits are perhaps 25% local currency or $46,000. These figures total $1,266,000 or 27% of the sub-total (excluding inflation and contingency). With 27% of the inflation and contingency level included ($96,000), the total local currency cost is estimated at $1,362,000 or 27% of total project costs.

Methods of Implementation and Financing
(in $,000's over the LOP)

Method of Implementation	Method of Financing	Approx. Amount
1. Technical Assistance		
PSC	Direct payment	418
Buy into Ctrl-funded Proj (incl. lcl cont)	Direct payment	1,019
IQC	Direct payment	260
Studies & Analyses	Direct payment	636
Competitive contract	Direct payment	300
2. Training		
Local Contract	Direct payment	800
Buy into Centrally-Funded Contract	Direct payment	350
IQC	Direct payment	138
Overseas (thru PIO/P)	Direct payment	400
3. Commodities		
Contractor, AID/W or USAID	Direct payment	153
4. Evaluation and Audit	Direct payment	182
Total		4,646*

* Inflation and Contingency not included.

E. Expected End of Project Status

By the end of FY 1996, the Economic Liberalization Project will have made major contributions to improvements in the business environment of Nepal. Optimism for a successful project and substantial reform is based on experiences of similar activities elsewhere, and the assumption that key decision-makers in Nepal will make appropriate, rational choices when presented with cogent analyses, recommendations, and demonstrations of the benefit of reform. Project success would be diminished by inappropriate GON political decisions that limit opportunities for private sector growth and expansion.

It is premature to list all expected changes that could be influenced or assisted by the Project. Whether or not a particular regulation will be changed in a certain way or a public enterprise forced to compete on an equal basis with private firms cannot be predicted at this time. What we do firmly believe we will see are basic changes in the overall business environment.

Through the creation of a policy dialogue process, which includes analyses of the impact of current and alternate regulations and policies which influence and structure business operations in Nepal, decisions on how business will operate in Nepal will be made through a rational, balanced process which shows how the business community, the consumer, the environment, and the GON will be benefitted by various options and approaches.

Besides influencing the policy framework for the business community in Nepal, the project will assist targeted business sectors with gaining specific skills, with an improved representative voice and support through chambers, associations and unions, and with the adoption of financial instruments and expansion of capital markets - the monetary tools required for growth and improvement. The business community, with these enhanced capabilities and resources, will be better able to create and seize opportunities for entry into the marketplace and for expansion of existing enterprises.

The Project will help Nepal move towards a more open and responsible business environment, exemplified by competition, a pro-market economy, and a government that facilitates equitable growth and access.

IV. SUMMARY OF PROJECT ANALYSES

Full project analyses are shown as Section VII. The summaries have been presented here to provide an overview of the Project's suitability and potential.

A. Economic Analysis

The Project is a cost effective way to use USAID and Nepali resources to achieve project goals. It will have to monitor a number of the experimental activities to permit on-going assessments of whether each individual component is successful and warrants continuation or adjustment.

The objective of the Project is to help create an environment where an open, competitive, private sector led, market economy can thrive. Only in these circumstances can the economy grow in a sustainable way and generate not only additional jobs, but needed foreign exchange and tax revenue to finance government programs and remain within Structural Adjustment deficit and domestic borrowing limits. The economic analysis (details in an Section VII A), looks at the returns to capital market development and its impact on privatization, simplification of registration and taxation, training, and strengthening business organizations. In each activity, under restrictive assumptions, there are sufficient benefits to make project activities worth the expenditures. In those cases where benefits are not yet known, the analysis proposes to establish a monitoring ability to assess which activities are cost effective and make adjustments accordingly.

B. Social Analysis

The Project faces a number of social challenges which are best examined in relationship to "sociocultural feasibility" and "benefit incidence/spread effects". These challenges are examined at greater length in section VII B, and only briefly catalogued here.

A key assumption of direct relevance to the Project's sociocultural feasibility, is that "Nepalese citizens will respond quickly and in large numbers to Project-supported openings in the regulatory environment". In section VII B, the validity of this assumption is supported by several striking examples of initiatives by Nepalese private citizens to better their economic situation, in the process applying enormous energy and creativity in spite of daunting administrative and natural obstacles. It can be concluded that ample numbers of Nepalese will respond positively to economic openings created with Project support.

Another key assumption is that "Project activities will succeed in significantly altering an entrenched, obstructive, highly centralized administrative system which has hindered entrepreneurship and business growth in the past". Section VII B, examines causes for pessimism (entrenched bureaucracies, anti-business rhetoric in party platforms) and causes for optimism (dramatically increased opportunities for public dialogue under multi-party democracy, project components carefully matched to those opportunities). Brief analysis suggests that reasons for optimism outweigh those for pessimism; the Project is likely to succeed in supporting system reform.

Certain characteristics of Nepalese society pose a major challenge to the Project's capacity to achieve spread effects and equitable benefit distribution. Like other South Asian countries, Nepal has a few caste and ethnic groups ("jati") with members who are strongly "business-oriented"--higher Newar castes, some Brahmin groups, Marwaris, Thakalis, Sherpas, Manangis, Tibetans--and many others with members who have little inclination or opportunity to enter business--Tamangs, Tharu, some Brahmin groups, and occupational castes of Tailors, Blacksmiths, and Potters. Similarly, GON bureaucrats who administer and regulate business are drawn mainly from a narrow spectrum of elite jati, which partially overlap those of business people. Women are greatly under-represented among business owners, managers, and regulators. A Project which works toward business policy change must inevitably form alliances with businessmen, who are predominantly from business-oriented jati, and work closely with male, elite GON counterparts. Similarly, as Project managers seek candidates to receive short-term training and technical assistance, male members of a few privileged jati will be identified in large numbers, while women and members of other groups will be hard to find.

This sociocultural reality poses a dilemma for the Project. Determined pursuit of efficiency implies support for business groups as they currently exist in Nepalese society. For the foreseeable future, these are the groups best equipped to effectively use Project resources, both in extracting better policies from Government, and in expanding business in response to new opportunities. On the other hand, determined pursuit of equity implies conscious effort to work with women and members of disadvantaged (non-business) jati; over time such outreach efforts can be expected to expand the breadth of Nepal's business community, and increase overall capacity for growth.

Compromise between efficiency and equity is needed, perhaps by explicit adoption of alternate objectives of fairness and access in administering Project components. e.g., USAID should work only with groups genuinely open to businesswomen and to businessmen from non-business jati; even if there are few such members, we should be certain that appropriate candidates of all groups are assured entry. Similarly, when recipients of training and technical assistance are selected, USAID should insist that "the net be cast a little wider", and that a reasonable number of women and non-business jati members be selected.

C. Institutional/Administrative Analysis

In the past, key decisions on policies and regulations, which controlled the formal sector of the business community, were made largely by the Palace Secretariat. This body has been abolished and decision-making has been delegated to senior bureaucrats in certain ministries. Their capabilities and knowledge require considerable improvement and substantial strides can be made through the project.

The capabilities of the private sector to improve the Nepalese economy are somewhat greater, but collaboration with the government will be essential. Specialized training and technical assistance will enhance the business community's capabilities, especially through representative groups such as chambers and associations.

The potential for an improved business environment can be increased and realized through the efforts of better-informed, analytical and rational government leaders, working closely with a competitive, open private sector that responds to the demands of consumers.

V. IMPLEMENTATION PLAN

A. Implementation Schedule

The life of project will extend over a period of five years. Many activities will be conducted throughout the expected time frame. For example, the design of new regulations and revision of old ones will continue throughout the project, although the revision of any single regulation may be accomplished within a few months. Business skill training will continue for the full project period, but a given course may be conducted once or twice only. Therefore, the initiation of priority activities wil be shown, not as individual tasks, but as a group. The contractual or technical assistance modality for priority activities is still being explored and it should not be assumed that the types of technical assistance agreements are already known. As it is intended that all activities be initiated by the end of FY 1992, the Implementation Schedule will not show activities after that time.

As the project will build on its successes and seize opportunities as the economic environment changes, the Implementation Schedule is considerablly looser and more open than it would be for a more "traditional" project that addresses a narrower set of concerns.

Activity	Actions	Timing
PP Approval	USAID	August, '91
Project Agreement signed	USAID, MOF	Sept., '91
Conditions Precedent met	MOF	Oct., '91
PSCs recruited	USAID	Nov., '91
Regulations analyses started	IRIS, MOC, Chambers, Associations, MOF	Nov., '91
Business Development and Policy Dialogue Steering Committees Formalized	GON, Business Community, USAID	Nov., '91
Business Training Needs Assessment Started	IQC and local firm	Nov., '91
Chambers and Associations Needs Assessments Initiated	CIPE, AMA, JCC?, Local Consultants, Chambers, Associations	Nov.-Dec.,'91
Regulatory Reform Advocacy Program Started	IRIS, Business Groups, GON Leaders	Nov.-Dec., '91
Business Training Programs Designed	Exec vols, local consultants (SBPP?)	Nov.-Dec., '91

Major Study of Trade Issues Initiated	IQC, Buy-in?, Local Consulting Firm	Dec.-Jan.,'91
Potential Support for New Capital Markets Explored	ATI, IQC, Buy-ins, exec vols?	Jan.-Feb., '92
Business Training Needs Program Started	exec vols, local consultants, U.S. Univ?	Feb.-Mar., '92
Institutional Support for Chambers and Association Started	CIPE, AMA, JCC? Local Chambers, Associations	Feb.-Mar., '92
Trade Support Activities Launched	IQC, Buy-in, Local Firms?	Mar.-Apr., '92
Initiation of Pilot Capital Market Expansion Program	IQC, Buy-in, exec volunteers?	April-May, '92

B. Evaluation, Monitoring and Audit

The complexity of the project, with numerous sub-activities and various technical assistance entities, enlarges the monitoring requirements significantly. Monthly monitoring will be the responsibility of the U.S. individual recruited under a personal services contract (PSC) and a foreign service national (FSN) also recruited under a PSC. These people will be responsible for the daily administration of the numerous analyses (see time table in previous section) and the implementation of subsequent programs. They will also be required to monitor performance by the technical assistance personnel and local institutions. Monitoring reports should follow the simple pattern of reviewing progress to date and activities planned for the next period, identifying problems and needs for decisions, drawing conclusions, and recommending (to USAID and steering committees) courses of action. In turn, the USAID Project Manager will need to analyze these monitoring reports, recommend courses of action, and collaboratively implement the programs and changes, as necessary.

Full blown project evaluations should be conducted after two years and after four years from project initiation. This should roughly fall around the summers of 1993 and 1995. As the activities conducted under the project are selected periodically when the circumstances warrant action and new opportunities are identified a major evaluation will be necessary fairly early on in the LOP. This evaluation will help Mission personnel and steering committees' members decide which activities to expand, continue as they are, or curtail. An outside, firm experienced in business strengthening and policy dialogue programs for developing countries should be contracted for this effort, using project funds. Local expertise and a GON liaison person on the evaluation team will be included. Because of the innovative nature of the Project, a mid-term evaluation will be held within 18-24 months aften the condition precedent is met to assess progress, ascertain revisions, and if necessary, form the basis for PP amendment.

An audit of the project activities may be necessary near the late third of the project life. An audit for this kind of project, however, will be extremely difficult, as there will be many sub-contractors involved in implementation (IQC's, buy-ins, local contractors, etc.). Therefore, it is essential that the Project Manager and Financial management Office maintain good financial records of all transactions and insist that all contractors provide detailed financial reports on all uses of Project funds.

Based on analysis of project activities, it is concluded that preferred methods of implementation and financing are either direct payments or letters of credit. Audits are normally conducted (of U.S. contractors) by the Defense Contract Agency under the auspices of the AID Inspector General. It is anticipated that RIG/A/Singapore will conduct a project or functional audit during the life of the Project. USAID/Nepal will coordinate with RIG/A on determination of the timing for this audit. $50,000 have been budgeted accordingly.

C. Administrative and Managerial Responsibilities

The administrative and managerial responsibilities which fall to USAID/Nepal are substantially heavier than for most bilateral projects. As most activities in the project focus on the private, non-governmental sector and require input from many different entities, the responsibilities are more complex. The Mission will not be able to rely on a single contractor or a single GON ministry for project implementation. For this reason, USAID/Nepal will recruit a U.S. and Nepali PSC to work exlcusively on this project. Under the supervision of the U.S. Direct Hire (USDH) Project Manager, they will be responsible for most daily administration. Portions of the burden will also be shouldered by other USAID offices.

The Contracts Officer and his procurement staff will be required to provide details for some IQCs and project buy-ins (although AID/W Contracts (MS/OP) will often negotiate and sign agreements on the Mission's behalf). These firms will execute local contracts as necessary. If the Mission no longer has a USDH Contracts Officer (current officer is expected to depart o/a 10/92 and not be replaced), it will be necessary to rely on the Regional Contracts Officer or MS/OP.

The Financial Management Office (FM) will be responsible for disbursements and for financial record-keeping (along with project personnel). No major complications are envisioned, although it is acknowledged that the number of contracts and subsequent number of transactions will increase FM's workload. Buy-ins will be executed through AID/W Contracts.

The Program and Project Development Office (PPD) will be responsible for negotiating agreements with the GON, for amending project funding obligations, for administering evaluations, and for monitoring project reporting. PPD will provide support, as required, for any other administrative requirements not handled by the Project Manager or PSC.

The administrative responsibilities of the Government of Nepal will be minimal. If the Project can be adequately forward funded, there will be very limited administrative requirements. The initial agreement will be signed with the Ministry of Finance. The GON, through the Ministries of Finance, Commerce, Industry, and Tourism, will participate on the Business Strengthening and Policy Dialogue Steering Committees. Various government organizations will undoubtedly be involved with training activities, introduction of new financial instruments and regulatory reform. Involvement in these activities will not be administrative, however, but will be directly through the roles of implementers and active participants. Formal approval for project activities from the GON is expected only at the time of signing the project agreement. Thereafter, the GON is seen, through numerous governmental bodies, as a constant partner in the Project's implementation.

D. Technical Assistance Modality

It is expected that use of Buy-ins and IQCs contracts under a variety of contract arrangements will be needed to implement the Project. Each sub-activity may require one or more modalities for providing technical assistance. Buy-ins will be the primary vehicle for long-term consulting. IQCs will be used for short-term, specific tasks. Local contracts will be executed by the relevant U.S. contractor as part of its full contract. Studies and analyses will be performed through local consultancies, directly contracted by USAID. This will also be the arrangement for local and overseas training.

Because the skills and expertise are so varied for different activities, it is improbable that one organization could be capable of carrying out all the tasks to be implemented under the project. The Agency for International Development, has used a number of simplified contracting modalities that can be used for implementing project activities. As assistance of a particular type can very well transcend national boundaries and differences, certain world-wide projects have been designed to provide expertise from a competitively selected firm/organization without recourse for each similar activity to a lengthy selection system. "Pre-selected" firms providing technical assistance can be contracted through buy-ins or IQCs. A buy-in is an excellent means of using an existing project to conduct activities in Nepal which fall within the purpose of that project and the expertise of the contractor, usually over an extended period of time. An IQC is a particular useful modality for a short-term activity (such as an analysis or particular training course), as direct contracting can be done quickly with organizations which have proven expertise.

At this time, the Mission has identified five possible contractors/consulting organizations for providing technical assistance. No firm decisions have been made, however, and these should be considered tentative. Under the Competitive Market Development Activity (Policy Dialogue), it is possible that buy-ins to two projects will be executed. The project titles are Center for Applied Economic Research (CAER, through Harvard University) and Institutional Reform and the Informal Sector Center (IRIS, through the University of Maryland). Both projects are administered by APRE in AID/W.

For various preliminary analyses and assessments, both buy-ins and IQCs could possibly be used. For example, the private sector training needs assessment could be done through an IQC with the Academy for Educational Development or with Ernst & Young. APRE staff in Washington are currently exploring options on the Mission's behalf. By the time the Project Agreement is signed, the Mission will have a much better sense of what contracting modalities are appropriate.

E. Commodity Procurement Plan and Waiver Requirements

The commodities to be procured under the project are for use in upgrading certain local institutions including chambers of commerce, and trade associations. Long-term, resident technical assistance is probably not required, except possibly for the regulatory environment activity, and therefore few supporting commodities should be necessary. The types of commodities which will be procurred for local chambers and associations are materials for libraries (books, periodicals, catalogues), certain office electronic equipment (photocopiers, typewriters), and computers (PCs, printers and software). Waivers may be necessary for geographic code 935 procurement, but will be solicited when the need arises. Procurement will probably be done locally, using the Mission Procurement Office staff. Commodities will be retained by the local institutions as their property, after project completion (with USAID's concurrence). If commodities are procured for any contractor, at project completion they will be disposed of at the disposition of the Private Sector Steering Committee.

Most technical assistance will be directly provided to the private sector. The Competitive Market Development component uses policy dialogue and reform as the standard approach for carrying out activities. Although both the private sector and the public sector will be making contributions to these activities, it would be extremely difficult, if not prohibitively expensive and time-consuming to determine and track local financial and in-kind contributions to project efforts. Similarly, many private sector strengthening activities have locally generated cost elements, but it would not be cost effective to attempt to track and record these in many instances. Therefore, the Mission will seek Assistant Administrator approval of a waiver of the requirement for 25% contribution by the host government in project costs. Those elements of the project which require direct cash contributions from the private sector or government, such as training assistance (IESC, for example), will be tracked and reported. A waiver of the 25% requirement is shown as Annex D and will be sent to the Asia AA when the project is approved.

The Mission recognizes, as per the PID approval cable (State 030658) attached as Annex A, paragraph 6, that additional initial environmental exminations (IEEs) will need to be undertaken if industrial parastatals are assisted in privatization as part of the Project. The remainder of the Project was granted a categorical exclusion by the Bureau Environmental Officer.

F. Conditions Precedent

As most elements of the Project involve working directly with the private sector and indirectly with the Government of Nepal, the only condition precedent will be the provision of required signatories of GON officials and their signatures who are eligible to represent His Majesty's Government for the purposes of signing project-related documents (project implementation orders, project implementation letters, project amendments, etc.)

Steering committees, as described in Section V B, will be formally constituted at the earliest possible moment, but this is not a requisite for the use of funds. It is the intention of USAID/Nepal to obligate all performance funds granted by AID/W for the project at the signing of the project agreement ($5,000,000). Therefore, it is unlikely that more than one or two amendments or project implementing documents will require signatures thereafter.

ACTION: AID-2 INFO AMB DCM PF (5)

ANNEX A

VZCZCKT0999RA0258
PP RUEHKT
DE RUEHC #3658/01 0310016
ZNR UUUUU ZZH
P 310018Z JAN 91
FM SECSTATE WASHDC
TO AMEMBASSY KATHMANDU PRIORITY 5809
BT
UNCLAS SECTION 01 OF 02 STATE 032658

ACTION COPY

LOC: 028 232
31 JAN 91 0319
CN: 04102
CHRG: AID
DIST: AID

AIDAC

E.O. 12356: N/A
TAGS:
SUBJECT: ECONOMIC LIBERALIZATION PID REVIEW- 367-0161

1. THE PROJECT REVIEW COMMITTEE MET 1/9/91 TO DISCUSS ECONOMIC LIBERALIZATION PROJECT. USAID/NEPAL WAS REPRESENTED BY DEPUTY DIRECTOR TEDDY WOOD-STERVINOU. THE MISSION IS COMMENDED FOR A WELL THOUGHT-OUT PROJECT WHICH HITS AT THE HEART OF SOME KEY DEVELOPMENT CONCERNS. ALTHOUGH STILL BROAD, THE PROJECT IS MORE FOCUSSED THAN ORIGINAL CONCEPTS PRESENTED IN NPD. REPRESENTATIVES AT THE MEETING PRAISED THE PROJECT FOR BEING EMINENTLY REASONABLE, AND A NICE MIX OF INSTITUTIONAL ELEMENTS. PID APPROVAL AUTHORITY FOR THIS PROJECT IS HEREBY DELEGATED TO THE MISSION, SUBJECT TO THE RESOLUTION OF DPPP FUNDING ISSUES, PER PARA 5 BELOW. BUREAU AND PPC COMMENTS WHICH YOU MIGHT FIND HELPFUL ARE AS FOLLOWS:

2. WHILE THERE WAS GENERAL AGREEMENT THAT ALL AREAS SELECTED FOR CONCENTRATION ARE WORTHWHILE, ANY ONE OF THEM COULD ABSORB THE ENTIRE PROJECT FUNDING. THE SUCCESS OF THE PROJECT DEPENDS ON SOUND ANALYSES AND THE ABILITY TO PERSUADE KEY GROUPS, AND IT IS CRITICAL THAT ORGANIZATIONS AND GOVERNMENT OFFICIALS BE IDENTIFIED WHO ARE IN POSITIONS OF AUTHORITY TO FOSTER CHANGES IN REGULATIONS AND POLICIES.

ACTION	INCOMING OFFICE	INFO
	D/DD	✓
	PPD	✓
	HR	✓
	PD	✓
✓	ECON	
	[illegible]	
	A[illegible]	
	HEP	
	FM	
	IRM	
	EXO	
	PER	
	GSO	
	PROC	
	RF	✓

ALTHOUGH WE UNDERSTAND THAT MISSION IS WORKING IN COLLABORATION WITH MULTILATERAL INSTITUTIONS, THE PROJECT MAY STILL BE AMBITIOUS, CONSIDERING FUNDING AND STAFFING CONSTRAINTS.

AT THIS JUNCTURE, THE BUREAU DOES NOT INTEND TO DICTATE THAT YOU STREAMLINE THE PROJECT TO FOCUS ON FEWER PROGRAM AREAS. HOWEVER, THE WIDE SCOPE OF THE PROJECT IS A CONCERN. WHAT WE ASK IS THAT YOU LOOK AT THIS ISSUE AGAIN DURING THE PP DESIGN. AT THAT TIME, IF SOME AREAS LOOK MORE PROMISING IN TERMS OF POTENTIAL IMPACT AND LIKLIHOOD OF SUCCESS, YOU MAY WISH TO FURTHER FOCUS THE PROJECT. IN THE FINAL ANALYSIS, IT'S YOUR CALL.

FILE COPY
ACTION TAKEN
CABLE ....
LETTER ....
O/R ....
N/A ....
DATE 1/31
OFFICE & INITIALS

APRE/DR/PD WILL BE HAPPY TO ASSIST IN A SEARCH THROUGH

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CDIE RESOURCES TO LOCATE AND SHARE AGENCY EXPERIENCE WITH THIS APPROACH IN OTHER MISSIONS, SUCH AS POLICY REFORM ACTIVITIES IN INDONESIA.

3. STAFFING AND MANAGEMENT CONCERNS WERE DISCUSSED AT SOME LENGTH, BECAUSE THE BURDEN ON MISSION STAFF AND MISSION MANAGEMENT FOR ANY ONE OF THESE PROJECT COMPONENTS WILL BE INTENSIVE, GIVEN THE NATURE OF PURSUING A BROAD POLICY AGENDA. AT THE STAFF LEVEL, PROJECT MANAGEMENT WILL BE MORE THAN A FULL-TIME JOB BECAUSE OF THE COMPLEXITIES - ECONOMIC, SOCIAL, POLITICAL AND INSTITUTIONAL - THAT WILL NEED TO BE DEALT WITH ON A DAY-TO-DAY BASIS TO FURTHER THE POLICY REFORM AGENDA WITH KEY PLAYERS FROM THE PUBLIC AND PRIVATE SECTORS. MISSION IS ENCOURAGED TO EXPLORE BUILDING IN PSC, PREFERABLY IN-COUNTRY OR OTHER MANAGEMENT POSITION INTO PROJECT FUNDING TO ASSIST WITH PROJECT MONITORING.

4. REPRESENTATIVE FROM APRE/I INDICATED WILLINGNESS TO CONTRIBUTE DOLS. 2 TO 3 MILLION IN GUARANTEE AUTHORITY FOR ACTIVITIES UNDER THIS PROJECT. MOST APPROPRIATE USE MIGHT BE IN ESTABLISHMENT OF LEASING COMPANY. INVESTMENT OFFICE BELIEVES THAT THIS PROJECT WILL PUT A.I.D. IN A GOOD POSITION TO MAKE EXPLICIT, TANGIBLE CONTRIBUTIONS TO THE ECONOMY ONCE THINGS IN THE FINANCIAL SECTOR BEGIN TO CHANGE. BRYAN KURTZ IN APRE/I WILL WORK WITH MISSION TO DEVELOP THIS PROPOSAL.

5. FUNDING QUESTIONS: THIS PROJECT WAS APPROVED LAST

FISCAL YEAR FOR PERFORMANCE FUNDING OF DOLS. 4 MILLION. MISSION NOW INDICATES FUNDING OF DOLS. 5 MILLION, INCLUDING LOP OF DOLS 2 MILLION IN AGRICULTURE ACCOUNT. (FYI: PID DOES NOT SEEM TO JUSTIFY THAT LEVEL OF AGRICULTURAL FUNDING FOR THIS PROJECT. REFORMS IN AGRICULTURE ARE ALREADY BEING ADDRESSED THROUGH THE AGROENTERPRISE AND TECHNOLOGY PROJECT.)

PERFORMANCE FUNDS FOR THIS PROJECT, IF AVAILABLE AT ALL, WILL BE FOR FY 91 OBLIGATION ONLY SINCE DPRP RULES REQUIRE ONE-SHOT, MORTGAGE-FREE FUNDING. FYI: DPRP FUNDS WILL BE SHOWN AS AID/W CENTRAL, NOT BILATERAL OBLIGATIONS.

DECISIONS ON AVAILABILITY OF PERFORMANCE FUNDS ARE NOT EXPECTED TO BE MADE UNTIL SEQUESTRATION QUESTIONS ARE RESOLVED, EXPECTED TO BE IN APRIL. MISSION IS, HOWEVER, ENCOURAGED TO PROCEED WITH DEVELOPMENT OF PROJECT PAPER. AFTER SEQUESTRATION DECISION IS MADE IN APRIL,

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FURTHER GUIDANCE WILL BE PROVIDED.

6. IEE: THE BUREAU ENVIRONMENTAL OFFICER DOES NOT AGREE THAT THIS PROJECT SHOULD BE GIVEN A NEGATIVE DETERMINATION ON THE IEE, SINCE IT IS UNCLEAR WHICH STATE ENTERPRISES WILL BE INCLUDED IN THE PRIVATIZATION COMPONENT OF THE PROJECT. SEVERAL OF THE CANDIDATES FOR ASSISTANCE AND FEASIBILITY STUDIES, SUCH AS THE HIMAL CEMENT CO, HETAUDA CEMENT CO, BHIRIKUTI PAPER MILLS AND BIRGUNJ SUGAR MILL HAVE POTENTIAL ENVIRONMENTAL IMPACTS WHICH SHOULD BE EXAMINED. THEREFORE AN ADDITIONAL IEE SHOULD BE UNDERTAKEN ONCE SPECIFIC INDUSTRIES AND ENTERPRISES HAVE BE SELECTED TO DETERMINE WHETHER AN ENVIRONMENTAL ASSESSMENT IS REQUIRED. THE BUREAU ENVIRONMENTAL OFFICER CONCURS WITH CATEGORICAL EXCLUSION FOR THE REMAINDER OF THE PROJECT.

7. THE PP SHOULD PAY SPECIAL ATTENTION TO THE EVALUATION PLAN, INCLUDING A CLEAR, DISCRETE SET OF EVALUABLE OBJECTIVES AND THE METHODOLOGY FOR EVALUATING THE PROJECT.

8. A WAIVER OF THE 25 PERCENT HOST COUNTRY CONTRIBUTION IS NOT AUTOMATIC BECAUSE NEPAL IS AN RLDC. THE PP SHOULD INCLUDE A JUSTIFICATION FOR SUCH A WAIVER (CONSULT PIA ON WHAT IS REQUIRED.

9. PER DOA 652, ONCE FUNDING ISSUES ARE RESOLVED, THE DIRECTOR, USAID/NEPAL HAS THE AUTHORITY TO APPROVE THE

PP AND AUTHORIZE THE PROJECT. BAKER
BT
#0658

NNNN

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ANNEX B-1

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Life of Project: ____________
From FY91 to FY96
Total U.S. Funding: 5,000,000
Date Prepared: 6/6/91

Project Title and Number: ECONOMIC LIBERALIZATION (367-0161)

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Program or Sector Goal:	Measures of Goal Achievement:		Assumptions for Achieving Goal Targets:
-- Develop a pro-market, private sector-led economy.	-- Improved GNP. -- Reduction in export to import imbalance. -- Expanded private sector. -- Increased investments in Nepal.	-- National economic data (Central Bank). -- Registration of new firms. -- Increased productive loans.	-- GON improves regulatory environment and implements it. -- Open competition in all business sectors allowed.
Project Purposes:	Conditions Needed: EOPS	Means of Verification	Assumptions
-- Define and implement policies that facilitate a pro-market, private sector-led economy. -- Assist private organizations and firms in responding to new economic opportunities.	-- Policy framework for business regulations which is simpler, unbiased, and facilitative. -- Price controls reduced or eliminated. -- FX available for productive purposes. -- Credit facilities for business growth and entry available. -- An environment is created in which policy decisions are made through a dialogue process with all concerned parties and based on careful analyses of options and benefits. A business climate which is growth-oriented, equitable and responsive to the needs of the populace.	-- Relevant regulations from various ministries reviewed (by consultants). -- Project evaluations in FY93 and FY95 (AID) -- Data on foreign exchange and loans (Central Bank) -- Steering committee.	-- Key decision-makers activate reform programs for regulations on a rational basis. -- The new government is open to a private sector-led, demand-driven economy, where competition and a supportive attitude prevail.

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ANNEX B-2

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Life of Project: ____________
From FY91 to FY96
Total U.S. Funding: 5,000,000
Date Prepared: 6/6/91

Project Title and Number: ECONOMIC LIBERALIZATION (367-0161)

NARRATIVE SUMMARY	OBJECTIVELY VERIBIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Outputs:	Magnitude of Outputs:		Assumptions for Achieving Outputs:
-- Regulatory reform process thru policy dialogue is initiated and implemented. -- Financial markets and instruments are expanded. -- State owned enterprises (PEs) are required to compete with private sector w/o subsidies or price controls. Management contracts of PEs are considered. -- Access to foreign exchange expanded for productive purposes.	-- A process of analysis, review, and rational decision-making on regulatory policies is implemented. At least five policy areas are reviewed -- Regulations permit establishment of new finance companies and banks. Long-term credit for business development is made available. -- Entry into "closed sectors" is allowed and price controls reduced. At least two PEs or privately managed or liquidated by LOP. -- Foreign exchange allocation system liberalized to permit open competition and allow some retention of FX earnings in country.	-- Evaluations in FY93 & FY95 -- Consultant review of pertinent regulations. -- Data reports (Central Bank). -- Regular project reporting and monitoring. -- Review of AID contracts with consulting firms.	-- Business/economic environment is conducive to growth and new entries. -- Financial institutions adopt financial instruments into portfolio. Additional finance companies started. -- Business sectors are opened for competition between PEs and private enterprises. Management contracts are started. -- Foreign exchange allocation is rationalized and liberalized. Exporters can retain a certain level of FX they earn.

ANNEX B-3

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Life of Project: ____________
From FY91 to FY96
Total U.S. Funding: 5,000,000
Date Prepared: 6/6/91

Project Title and Number: ECONOMIC LIBERALIZATION (367-0161)

NARRATIVE SUMMARY	OBJECTIVELY VERIBIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Input:	Implementation Target (Type and Quantity):		Assumptions for Providing Inputs:
-- Overseas TA	-- About 130 person months of TA provided	-- Contract with TA firms	-- USAID receives performance funds of $5,000,000 from AID/W.
-- Local TA	-- About 280 person months of local TA provided	-- PIO/Ps for training or training contracts	
-- Major studies/Analyses	-- About 25 analyses done, requiring 1-3 pm overseas and 2-6 pm local TA each	-- PIO/C checked -- Evaluations and reports	
-- Training:			
-- Study Tours and Trade Fairs	-- About 54 person months of study tours in U.S. and region (3 weeks courses)		
-- Skills training (local)	-- 700 person months of training (1-3 weeks courses)		
-- Skills training (U.S.& regional)	-- 75 person months in U.S. and region (2-4 weeks courses)		
-- Commodities - for local institution and regulatory environment activities	-- limited office commodities procurred		

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ANNEX C

Notes on Resource Requirements

A series of basic assumptions on consolidated costs are used for budgetary purposes. These are seen as being equal for any identical line item under a different activity. These assumptions are as follows.

1. Technical Assistance (Overseas) - Except for the use of IESC, TA is shown at a lumpsum rate of $20,000 per person month, all inclusive. This sum includes salary, overhead, fringe, per diem, travel, insurance, fees, miscellaneous.

Technical Assistance (Local) - Again, all local TA is considered short-term. Local TA per person month is estimated at $1,000, all inclusive.

2. Studies/Analyses - Key analyses or studies, using both expatriate and local expertise, are estimated to cost roughly $30,000 per month for the first month and $20,000 per month (for the same study) thereafter.

3. Training - U.S. training is estimated at $10,000 per month per person. This includes airfare, per diem, tuition, and miscellaneous. Third country training, on a per person per month basis, is estimated at $3,000. Local training is estimated, using one ex-patriate and local assistance, at roughly $25,000 per course per month for a course with 25 participants or less.

4. Commodities - This a highly variable figure and will be estimated individually for each activity.

5. Evaluations - Two major evaluations are required, each taking six weeks, but requiring 2 TA personnel and local experts. Therefore, each are budgeted at $66,000.

6. Audit - A single audit may be required in the latter part of the project. Its cost, using local and third country expertise, is estimated at $50,000.

7. Inflation and Contingency - Inflation and contingency are shown at a compounded rate of 5%, starting in FY93 and applied to all costs.

I. Private Sector Strengthening

A. Local Institutions

1. TA (overseas) - An average of four person months per year from FY92-95, is budgeted. TA (Local) 12 pm per year of local TA is estimated over the LOP, plus continuation in FY96 of 6 pm. This totals $92,000 from FY92-95, and $6,000 in FY96.

2. Studies/Analysis - Two major studies should be initiated in FY91, of chambers and of associations. The costs are estimated

at $50,000 (two person months). In FY94, an update study/analysis should be done, costing $30,000.

3. Training - Training for chambers and associations themselves (as opposed to business skill training for members and the business community) will consist of study tours to countries in the region and the U.S., plus a limited amount of training in management and public relations. Assuming the project works closely with two chambers and two associations initially, two study tours for six people each, lasting one month (2 weeks in Asia and 2 weeks in the U.S.) will be conducted in FY92. This equates to $6,500 per person or $39,000. Short courses in management and public relations, plus possible other programs in the region may equal six person months per year in the region ($18,000). By FY94, the project will probably expand and assist two more chambers and two more associations for intensive training. Study tours will be repeated and short courses include six more person months per year. No training will be provided in FY96, when the project is winding down. Local training is shown under Business Skills strengthening.

4. Commodities - For each chamber and association (four in FY92 and four new ones in FY94), it is probable that the following commodities will be purchased; PC computer, printer, software, typewriter, photocopier and library catalogues. Subscriptions valued at $1,000 p.a., will be provided from FY92 for four organizations, and FY94 for an additional four organizations through the LOP.

B. <u>Business Skill Training</u>

1. TA (Overseas and Local) may be necessary for the establishment of local training programs, to help organizations determine an appropriate curriculum, and to select/locate trainers. A rough estimate of two person months overseas TA and six p.m. of local TA is calculated as the requirement per annum from FY92-FY95. This would cost roughly $46,000 per annum. Local TA is continued in FY96.

2. Analyses/Studies - A major business training needs assessment will be done in the first year of the project. This will take roughly two person months ($50,000). An update should be done in FY94, using one person month ($30,000).

3. Training - This is the major training activity of the project. Reference can be made to the Training Plan (Annex F). Five separate categories of courses are shown. Local training totals 67.5 p.m. per annum and at $1,000 per person month, $67.500 per year from FY92-FY95. U.S. training totals 3 p.m. per year ($30,000), with regional training at 4 pm per year costing $12,000. Specialized local training from IESC is shown at $10,000 p.m., 4 months per year from FY92-FY95.

C. Trade Support

1. TA (Overseas) support, is estimated at 2 p.m. each per annum from FY92-FY95 with local TA at 4 pm per year from FY92-FY96. This equals $40,000 and $4,000 p.a. respectively.

2. Studies/Analyses - Three trade sectors have been identified for initial assessment and analyses. These should be done in FY91, costing $30,000 each all inclusive. It is estimated that one study/analysis will be done per annum thereafter until FY96.

3. Training - Combined U.S. and regional training is planned. From FY92 to FY95 at 15 p.m. per year with an estimated cost of $7,000 p.m. (total $105,000 per year). Local training is estimated at $20,000 (20 p.m.) per annum.

II. Competitive Market Development

A. Regulatory Environment

1. TA (Overseas) is estimated at six person months annually from FY92-FY95. The figure of $120,000 per annum is all inclusive and contains TA support for the numerous studies and analyses that will be conducted. Local TA is estimated at 36 p.m. per year from FY92 and includes expenses associated with running a local office (roughly $6,000 a year). A cost of $300 per person month is used, again all inclusive. Therefore local TA equals $17,000 per annum.

2. Studies/Analysis - Perhaps as many as eight separate studies/analysis will be done per annum, each looking at distinct categories of regulations. Overseas TA costs are covered, so studies are estimated at roughly $3,000 each for all other costs. Studies will be initiated in FY92 and completed in FY95.

3. Training - As noted in Annex F, only local training is shown for this activity. In years FY92 and FY93, forty person months are expected. In years FY94 and FY95, 25 person months are expected. The cost is estimated at $1,000 per person month.

4. Commodities - For the establishment of a simple office, including equipment and furniture, an estimated $25,000 is budgeted. Local TA showed office operating costs. At the completion of the project, USAID/Nepal will dispose of the property through donation to a local Non Governmental Organization (NGO), as agreed upon with the Private Sector Steering Committee.

B. Open Entry System

1. TA (Overseas) for this activity is estimated at three p.m. per year ($60,000), and 6 pm local TA ($6,000). Overseas TA should run from FY92-95 and local TA FY92-96.

2. Studies/Analysis - Two p.m. for a major assessment is budgeted for FY91, with one study/analysis each year thereafter for four years. Costs are therefore $50,000 in FY91 and $30,000 thereafter upto FY96. It is unlikely that commodities will be funded by the project for this activity, unless options 3-5 become viable.

3. Training - Training corresponds to the information supplied in Annex F. Per annum, from FY92-FY95, local training totals 40 p.m. per year ($40,000). U.S. training totals 2 p.m. per year ($20,000) and regional 2 p.m. per year ($6,000). Unless a major activity is initiated with credit unions or the HFDC, it is not likely that any commodities will be procured.

III. Mission Administrative Support

In order to carry out project activities, an expatriate project officer and a foreign service national will be needed. Their principal functions will be to administer the project, provide logistics, monitor and track activities. (The Project Manager's major functions will be to conduct a continuous policy dialogue with the GON and business community and to oversea contractor selections.) The support for the project officer and foreign service national will be financed through the project. The cost is estimated at $80,000 p.a. for the project officer and $8,000 p.a. for the foreign service national. They will start in the last quarter of FY91 and work through mid FY96.

IV. Evaluations

Two evaluations are scheduled, one in FY93 and another at the end of FY95. Their estimated cost is $66,000 each, as they are major efforts requiring extensive expertise. Three person months of expatriate expertise and six person months of local expertise will be required for each.

V. Audit

A single audit is scheduled for FY95, which will require regional or local expertise from an auditing firm. The cost is estimated at $50,000 total.

VI. Inflation and Contingency

Inflation is applied at a compounded rate of 5%, starting in FY93. This is applied to all budgetary elements. The rate is 5% in FY93, 10% in FY94, 16% in FY95 and 22% in FY96. Uninflated costs total $262,000 in FY91, $1,071,500 in FY92, $1,025,500 in FY93, $1,113,500 in FY94, $1,082,500 in FY95, and $91,000 in FY96. Inflation is therefore $51,000 in FY93, $111,000 in FY94, $172,000 in FY95, and $20,000 in FY96. Contingency is "included" in inflation.

Waiver Control No. 367-91-04

ANNEX D

ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR, BUREAU FOR ASIA

FROM: Eugene Morris, Asia/PD

SUBJECT: Nepal - Economic Liberalization Project (367-0161) Waiver of 25% Government of Nepal Funding Contribution [FAA Secs. 110, 124 (d)]

A.	Cooperating Country:	Nepal
B.	Authorization:	Project Authorization
C.	Nature of Funding:	Grant
D.	Nature of Waiver:	25% Funding Contribution by Host Government
E.	Amount of Waiver:	N/A (25% equals $1,250,000)

Summary: USAID/Nepal requests an AA/Asia waiver of the requirement that the Government of Nepal (GON) furnish 25% of total project costs, as stated in FAA Section 110 and 124 (d), because of the nature of the Economic Liberalization Project (367-0161).

Discussion: The Economic Liberalization Project is designed to assist Nepal in developing a pro-market, private sector-led economy that is strong, stable, and sustainable. The project has two major purposes: to help the GON define and implement policies that support a pro-market, private sector-led economy; and to assist private organizations and firms in using available economic opportunities. The basic strategy for implementation is to use continued policy dialogue for establishment of a regulatory and policy framework which supports private sector-led economic development. At the same time, highly focused support will be provided to the business community, through chambers associations, labor groups and individual business firms, that will enable the community to use new opportunities and achieve equitable growth.

Most technical assistance will be provided directly to the private sector. Although both the private and public sector will be contributing to the principal components of business strengthening and competitive market development, it would be extremely difficult, if not prohibitively expensive and time-consuming to determine and track local financial and in-kind contributions to project efforts. Where those contributions can be easily tracked, such as cost sharing on contracts (as with the International

Executive Service Corps) or training programs (airfares, salaries, use of facilities), the contributions will be monitored and reported. The amount, however, will not reach 25% of all project costs.

A large portion of the USAID budgeted funds are used for technical assistance, which will be working with existing private sector entities. New entities will not be created and large, project-related costs will not be incurred by these organizations. The GON's involvement will involve changing of regulatory systems and their application. There are no major cost implications, only benefits. Because this project is mainly concerned with policy reform and improved services of existing institutions, direct project costs for the business sector and the GON are relatively low and hard to differentiate from on-going requirements.

Recommendation: Therefore, USAID/Nepal seeks your approval of a waiver of the requirement for showing and tracking host country contributions of at least 25% of project costs, as permitted in Delegation of Authority No. 403, Section 4 and in accordance with the criteria in HB 3, Appendix 2 G.

Approved: K C Kammerer

Disapproved: ____________

Date: 8/8/91

Clearance: PPD/ECON:NCohen: ____________
FM:HJamshed: ____________

DD:TWStervinou: ____________
D:KCKammerer: ____________

Drafted by:THarris:sdl:6/7/91

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5C(1) - COUNTRY CHECKLIST

Listed below are statutory criteria applicable to the eligibility of countries to receive the following categories of assistance: (A) both Development Assistance and Economic Support Funds; (B) Development Assistance funds only; or (C) Economic Support Funds only.

A. COUNTRY ELIGIBILITY CRITERIA APPLICABLE TO BOTH DEVELOPMENT ASSISTANCE AND ECONOMIC SUPPORT FUND ASSISTANCE

1. **Narcotics**

a. **Negative certification** (FY 1991 Appropriations Act Sec. 559(b)): Has the President certified to the Congress that the government of the recipient country is failing to take adequate measures to prevent narcotic drugs or other controlled substances which are cultivated, produced or processed illicitly, in whole or in part, in such country or transported through such country, from being sold illegally within the jurisdiction of such country to United States Government personnel or their dependents or from entering the United States unlawfully?

No. Nepal is in compliance and is taking measures to prevent drugs from being manufactured, shipped or sold.

b. **Positive certification** (FAA Sec. 481(h)). (This provision applies to assistance of any kind provided by grant, sale, loan, lease, credit, guaranty, or insurance, except assistance from the Child Survival Fund or relating to international narcotics control, disaster and refugee relief, narcotics education and awareness, or the provision of food or medicine.) If the recipient is a "major illicit drug producing country" (defined as a country producing during a fiscal year at least five metric tons of opium or 500 metric tons of coca or marijuana) or a "major drug-transit country" (defined as a country that is a significant direct

N/A.

source of illicit drugs significantly affecting the United States, through which such drugs are transported, or through which significant sums of drug-related profits are laundered with the knowledge or complicity of the government):

(1) does the country have in place a bilateral narcotics agreement with the United States, or a multilateral narcotics agreement?

(2) has the President in the March 1 International Narcotics Control Strategy Report (INSCR) determined and certified to the Congress (without Congressional enactment, within 45 days of continuous session, of a resolution disapproving such a certification), or has the President determined and certified to the Congress on any other date (with enactment by Congress of a resolution approving such certification), that (a) during the previous year the country has cooperated fully with the United States or taken adequate steps on its own to satisfy the goals agreed to in a bilateral narcotics agreement with the United States or in a multilateral agreement, to prevent illicit drugs produced or processed in or transported through such country from being transported into the United States, to prevent and punish drug profit laundering in the country, and to prevent and punish bribery and other forms of public corruption which facilitate production or shipment of illicit drugs or discourage prosecution of such acts, or that (b) the vital national interests of the United States require the provision of such assistance?

c. **Government Policy** (1986 Anti-Drug Abuse Act of 1986 Sec. 2013(b)). (This section applies to the same categories of assistance subject to the restrictions in FAA Sec. 481(h), above.) If recipient country is a "major illicit drug producing country" or "major drug-transit country" (as defined for the purpose of FAA Sec 481(h)), has the President submitted a report to Congress — N/A.

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listing such country as one: (a) which, as a matter of government policy, encourages or facilitates the production or distribution of illicit drugs; (b) in which any senior official of the government engages in, encourages, or facilitates the production or distribution of illegal drugs; (c) in which any member of a U.S. Government agency has suffered or been threatened with violence inflicted by or with the complicity of any government officer; or (d) which fails to provide reasonable cooperation to lawful activities of U.S. drug enforcement agents, unless the President has provided the required certification to Congress pertaining to U.S. national interests and the drug control and criminal prosecution efforts of that country?

2. **Indebtedness to U.S. citizens** (FAA Sec. 620(c): If assistance is to a government, is the government indebted to any U.S. citizen for goods or services furnished or ordered where: (a) such citizen has exhausted available legal remedies, (b) the debt is not denied or contested by such government, or (c) the indebtedness arises under an unconditional guaranty of payment given by such government or controlled entity?

To the Missions knowledge, no such indebtedness exists.

3. **Seizure of U.S. Property** (FAA Sec. 620(e)(1)): If assistance is to a government, has it (including any government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?

Not to the Mission's knowledge.

4. **Communist countries** (FAA Secs. 620(a), 620(f), 620D; FY 1991 Appropriations Act Secs. 512, 545): Is recipient country a Communist country? If so, has the President: (a) determined that assistance to the country is vital to the security of the United States, that the recipient country is not controlled by

No.

the international Communist conspiracy, and that such assistance will further promote the independence of the recipient country from international communism, or (b) removed a country from applicable restrictions on assistance to communist countries upon a determination and report to Congress that such action is important to the national interest of the United States? Will assistance be provided either directly or indirectly to Angola, Cambodia, Cuba, Iraq, Libya, Vietnam, Iran or Syria? Will assistance be provided to Afghanistan without a certification, or will assistance be provided inside Afghanistan through the Soviet-controlled government of Afghanistan?

5. **Mob Action** (FAA Sec. 620(j)): Has the country permitted, or failed to take adequate measures to prevent, damage or destruction by mob action of U.S. property?

No.

6. **OPIC Investment Guaranty** (FAA Sec. 620(l)): Has the country failed to enter into an investment guaranty agreement with OPIC?

No.

7. **Seizure of U.S. Fishing Vessels** (FAA Sec. 620(o); Fishermen's Protective Act of 1967 (as amended) Sec. 5): (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing vessel because of fishing activities in international waters? (b) If so, has any deduction required by the Fishermen's Protective Act been made?

N/A.

8. **Loan Default** (FAA Sec. 620(q); FY 1991 Appropriations Act Sec. 518 (Brooke Amendment)): (a) Has the government of the recipient country been in default for more than six months on interest or principal of any loan to the country under the FAA?

No.

(b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the FY 1990 Appropriations Act appropriates funds?

No.

9. **Military Equipment** (FAA Sec. 620(s)): If contemplated assistance is development loan or to come from Economic Support Fund, has the Administrator taken into account the percentage of the country's budget and amount of the country's foreign exchange or other resources spent on military equipment? (Reference may be made to the annual "Taking Into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.)	N/A.
10. **Diplomatic Relations with U.S.** (FAA Sec. 620(t)): Has the country severed diplomatic relations with the United States? If so, have relations been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?	No.
11. **U.N. Obligations** (FAA Sec. 620(u)): What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the A.I.D. Administrator in determining the current A.I.D. Operational Year Budget? (Reference may be made to the "Taking into Consideration" memo.)	Payments are current, to the best of the Mission's knowledge.
12. **International Terrorism**	
a. **Sanctuary and support** (FY 1991 Appropriations Act Sec. 556; FAA Sec. 620A): Has the country been determined by the President to: (a) grant sanctuary from prosecution to any individual or group which has committed an act of international terrorism, or (b) otherwise support international terrorism, unless the President has waived this restriction on grounds of national security or for humanitarian reasons?	No.

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b. **Airport Security** (ISDCA of 1985 Sec. 552(b). Has the Secretary of State determined that the country is a high terrorist threat country after the Secretary of Transportation has determined, pursuant to section 1115(e)(2) of the Federal Aviation Act of 1958, that an airport in the country does not maintain and administer effective security measures?

No.

13. **Discrimination** (FAA Sec. 666(b)): Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA?

No.

14. **Nuclear Technology** (FAA Secs. 669, 670): Has the country, after August 3, 1977, delivered to any other country or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards, and without special certification by the President? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or detonated a nuclear explosive device? If the country is a non-nuclear weapon state, has it, on or after August 8, 1985, exported (or attempted to export) illegally from the United States any material, equipment, or technology which would contribute significantly to the ability of a country to manufacture a nuclear explosive device? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.)

No. Not to the Mission's knowledge.

15. **Algiers Meeting** (ISDCA of 1981, Sec. 720): Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Assembly of the U.N. on Sept. 25 and 28, 1981, and did it fail to disassociate itself from the communique issued? If so, has the President taken it into account? (Reference may be made to the "Taking into Consideration" memo.)

No. Not to our knowledge. Nepal has dissassociated itself from the communique.

16. **Military Coup** (FY 1991 Appropriations Act Sec. 513): Has the duly elected Head of Government of the country been deposed by military coup or decree? If assistance has been terminated, has the President notified Congress that a democratically elected government has taken office prior to the resumption of assistance?

No.

17. **Refugee Cooperation** (FY 1991 Appropriations Act Sec. 539): Does the recipient country fully cooperate with the international refugee assistance organizations, the United States, and other governments in facilitating lasting solutions to refugee situations, including resettlement without respect to race, sex, religion, or national origin?

Yes.

18. **Exploitation of Children** (FY 1991 Appropriations Act Sec. 599D, amending FAA Sec. 116): Does the recipient government fail to take appropriate and adequate measures, within its means, to protect children from exploitation, abuse or forced conscription into military or paramilitary services?

B. COUNTRY ELIGIBILITY CRITERIA APPLICABLE ONLY TO DEVELOPMENT ASSISTANCE ("DA")

1. **Human Rights Violations** (FAA Sec. 116): Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy?

No.

2. **Abortions** (FY 1991 Appropriations Act Sec. 535): Has the President certified that use of DA funds by this country would violate any of the prohibitions against use of funds to pay for the performance of abortions as a method of family planning, to motivate or coerce any person to practice abortions, to pay for the performance of involuntary

No.

sterilization as a method of family planning, to coerce or provide any financial incentive to any person to undergo sterilizations, to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning?

C. COUNTRY ELIGIBILITY CRITERIA APPLICABLE ONLY TO ECONOMIC SUPPORT FUNDS ("ESF")

Human Rights Violations (FAA Sec. 502B): Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the President found that the country made such significant improvement in its human rights record that furnishing such assistance is in the U.S. national interest? N/A.

5C(2) - ASSISTANCE CHECKLIST

Listed below are statutory criteria applicable to the assistance resources themselves, rather than to the eligibility of a country to receive assistance. This section is divided into three parts. Part A includes criteria applicable to both Development Assistance and Economic Support Fund resources. Part B includes criteria applicable only to Development Assistance resources. Part C includes criteria applicable only to Economic Support Funds.

CROSS REFERENCE: IS COUNTRY CHECKLIST UP TO DATE?

A. CRITERIA APPLICABLE TO BOTH DEVELOPMENT ASSISTANCE AND ECONOMIC SUPPORT FUNDS

1. **Host Country Development Efforts** (FAA Sec. 601(a)): Information and conclusions on whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.

Yes to all of these. These are all purposes of the project.

2. **U.S. Private Trade and Investment** (FAA Sec. 601(b)): Information and conclusions on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

Open markets and improved trade are major project purposes.

3. **Congressional Notification**

a. **General requirement** (FY 1991 Appropriations Act Secs. 523 and 591; FAA Sec. 634A): If money is to be obligated for an activity not previously justified to Congress, or for an amount in excess of amount previously justified to Congress, has Congress been properly notified (unless the notification requirement has been waived because of substantial risk to human health or welfare)?

Yes. Prior to obligating funds, Congress will be notified through AID/W.

b. **Notice of new account obligation** (FY 1991 Appropriations Act Sec. 514): If funds are being obligated under an appropriation account to which they were not appropriated, has the President consulted with and provided a written justification to the House and Senate Appropriations Committees and has such obligation been subject to regular notification procedures?

N/A.

c. **Cash transfers and nonproject sector assistance** (FY 1991 Appropriations Act Sec. 575(b)(3)): If funds are to be made available in the form of cash transfer or nonproject sector assistance, has the Congressional notice included a detailed description of how the funds will be used, with a discussion of U.S. interests to be served and a description of any economic poolicy reforms to be promoted?

N/A.

4. **Engineering and Financial Plans** (FAA Sec. 611(a)): Prior to an obligation in excess of $500,000, will there be: (a) engineering, financial or other plans necessary to carry out the assistance; and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

Yes. Budget is shown in PP, Section III D and Annex C.

5. **Legislative Action** (FAA Sec. 611(a)(2)): If legislative action is required within recipient country with respect to an obligation in excess of $500,000, what is the basis for a reasonable expectation that such action

N/A.

will be completed in time to permit orderly accomplishment of the purpose of the assistance?

6. **Water Resources** (FAA Sec. 611(b); FY 1991 Appropriations Act Sec. 501): If project is for water or water-related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, _et seq._)? (See A.I.D. Handbook 3 for guidelines.)

N/A.

7. **Cash Transfer and Sector Assistance** (FY 1991 Appropriations Act Sec. 575(b)): Will cash transfer or nonproject sector assistance be maintained in a separate account and not commingled with other funds (unless such requirements are waived by Congressional notice for nonproject sector assistance)?

N/A

8. **Capital Assistance** (FAA Sec. 611(e)): If project is capital assistance (_e.g._, construction), and total U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability to maintain and utilize the project effectively?

N/A.

9. **Multiple Country Objectives** (FAA Sec. 601(a)): Information and conclusions on whether projects will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.

Yes to all of these. These are all purposes of the project.

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10. **U.S. Private Trade** (FAA Sec. 601(b)): Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

Open markets and improved trade are major project purposes.

11. **Local Currencies**

a. **Recipient Contributions** (FAA Secs. 612(b), 636(h)): Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.

The U.S. owns no Nepali rupees. Activities are done jointly with local entities and they will assist with funding LC costs are estimated at $1,350,000 (27%).

b. **U.S.-Owned Currency** (FAA Sec. 612(d)): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

No.

c. **Separate Account** (FY 1991 Appropriations Act Sec. 575). If assistance is furnished to a foreign government under arrangements which result in the generation of local currencies:

(1) Has A.I.D. (a) required that local currencies be deposited in a separate account established by the recipient government, (b) entered into an agreement with that government providing the amount of local currencies to be generated and the terms and conditions under which the currencies so deposited may be utilized, and (c) established by agreement the responsibilities of A.I.D. and that government to monitor and account for deposits into and disbursements from the separate account?

No local currency will be generated through this project.

(2) Will such local currencies, or an equivalent amount of local currencies, be used only to carry out the purposes of the DA or ESF chapters of the FAA (depending on which chapter is the source of the assistance) or for the administrative requirements of the United States Government?

(3) Has A.I.D. taken all appropriate steps to ensure that the equivalent of local currencies disbursed from the separate account are used for the agreed purposes?

(4) If assistance is terminated to a country, will any unencumbered balances of funds remaining in a separate account be disposed of for purposes agreed to by the recipient government and the United States Government?

12. **Trade Restrictions**

a. **Surplus Commodities** (FY 1991 Appropriations Act Sec. 521(a)): If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?

No. No assistance will be given to industries that will compete with U.S. producers.

b. **Textiles (Lautenberg Amendment)** (FY 1991 Appropriations Act Sec. 521(c)): Will the assistance (except for programs in Caribbean Basin Initiative countries under U.S. Tariff Schedule "Section 807," which allows reduced tariffs on articles assembled abroad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies, or project profiles of potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country markets in direct competition with U.S. exports, of

No.

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textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work gloves or leather wearing apparel?

13. **Tropical Forests** (FY 1991 Appropriations Act Sec. 533(c)(3)): Will funds be used for any program, project or activity which would (a) result in any significant loss of tropical forests, or (b) involve industrial timber extraction in primary tropical forest areas?

14. **PVO Assistance**

a. **Auditing and registration** (FY 1991 Appropriations Act Sec. 537): If assistance is being made available to a PVO, has that organization provided upon timely request any document, file, or record necessary to the auditing requirements of A.I.D., and is the PVO registered with A.I.D.?

If a PVO is used, then such documents will be required.

b. **Funding sources** (FY 1991 Appropriations Act, Title II, under heading "Private and Voluntary Organizations"): If assistance is to be made to a United States PVO (other than a cooperative development organization), does it obtain at least 20 percent of its total annual funding for international activities from sources other than the United States Government?

If, in the unlikely event a PVO is used, this requirement will be applied.

15. **Project Agreement Documentation** (State Authorization Sec. 139 (as interpreted by conference report)): Has confirmation of the date of signing of the project agreement, including the amount involved, been cabled to State L/T and A.I.D. LEG within 60 days of the agreement's entry into force with respect to the United States, and has the full text of the agreement been pouched to those same offices? (See Handbook 3, Appendix 6G for agreements covered by this provision).

This will be done when the Project Agreement is signed.

16. **Metric System** (Omnibus Trade and Competitiveness Act of 1988 Sec. 5164, as interpreted by conference report, amending Metric Conversion Act of 1975 Sec. 2, and as implemented through A.I.D. policy): Does the assistance activity use the metric system of measurement in its procurements, grants, and other business-related activities, except to the extent that such use is impractical or is likely to cause significant inefficiencies or loss of markets to United States firms? Are bulk purchases usually to be made in metric, and are components, subassemblies, and semi-fabricated materials to be specified in metric units when economically available and technically adequate? Will A.I.D. specifications use metric units of measure from the earliest programmatic stages, and from the earliest documentation of the assistance processes (for example, project papers) involving quantifiable measurements (length, area, volume, capacity, mass and weight), through the implementation stage?

Yes.

17. **Women in Development** (FY 1991 Appropriations Act, Title II, under heading "Women in Development"): Will assistance be designed so that the percentage of women participants will be demonstrably increased?

Yes.

18. **Regional and Multilateral Assistance** (FAA Sec. 209): Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided? Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.

No. Activities are national in scope. There will be close collaboration with multi-lateral donors (WB&IMF) and complementary activities will be undertaken.

19. **Abortions** (FY 1991 Appropriations Act, Title II, under heading "Population, DA," and Sec. 525):

a. Will assistance be made available to any organization or program which, as determined by the President, supports or participates in the management of a program of coercive abortion or involuntary sterilization?

No.

b. Will any funds be used to lobby for abortion?

No.

20. **Cooperatives** (FAA Sec. 111): Will assistance help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward a better life?

It is possible that cooperatives will be assisted (credit unions) and certainly activities are democratic by nature.

21. **U.S.-Owned Foreign Currencies**

a. **Use of currencies** (FAA Secs. 612(b), 636(h); FY 1991 Appropriations Act Secs. 507, 509): Describe steps taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. are utilized in lieu of dollars to meet the cost of contractual and other services.

The U.S. owns no Nepali rupees. Activities are done jointly with local entities and they will assist with funding LC costs are estimated at $1,350,000 (27%).

b. **Release of currencies** (FAA Sec. 612(d)): Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

No.

22. **Procurement**

a. **Small business** (FAA Sec. 602(a)): Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed?

Principally IQCs and Buy-ins will be used.

b. **U.S. procurement** (FAA Sec. 604(a)): Will all procurement be from the U.S. except as otherwise determined by the President or determined under delegation from him?

Yes. Otherwise appropriate waivers will be requested.

c. **Marine insurance** (FAA Sec. 604(d)): If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company?	Yes.
d. **Non-U.S. agricultural procurement** (FAA Sec. 604(e)): If non-U.S. procurement of agricultural commodity or product thereof is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.)	N/A.
e. **Construction or engineering services** (FAA Sec. 604(g)): Will construction or engineering services be procured from firms of advanced developing countries which are otherwise eligible under Code 941 and which have attained a competitive capability in international markets in one of these areas? (Exception for those countries which receive direct economic assistance under the FAA and permit United States firms to compete for construction or engineering services financed from assistance programs of these countries.)	N/A.
f. **Cargo preference shipping** (FAA Sec. 603)): Is the shipping excluded from compliance with the requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 percent of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent such vessels are available at fair and reasonable rates?	No.
g. **Technical assistance** (FAA Sec. 621(a)): If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? Will the	Yes.

facilities and resources of other Federal agencies be utilized, when they are particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs? Yes.

h. **U.S. air carriers** (International Air Transportation Fair Competitive Practices Act, 1974): If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available? Yes.

i. **Termination for convenience of U.S. Government** (FY 1991 Appropriations Act Sec. 504): If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States? Yes.

j. **Consulting services** (FY 1991 Appropriations Act Sec. 524): If assistance is for consulting service through procurement contract pursuant to 5 U.S.C. 3109, are contract expenditures a matter of public record and available for public inspection (unless otherwise provided by law or Executive order)? Yes.

k. **Metric conversion** (Omnibus Trade and Competitiveness Act of 1988, as interpreted by conference report, amending Metric Conversion Act of 1975 Sec. 2, and as implemented through A.I.D. policy): Does the assistance program use the metric system of measurement in its procurements, grants, and other business-related activities, except to the extent that such use is impractical or is likely to cause significant inefficiencies or loss of markets to United States firms? Yes.

Are bulk purchases usually to be made in metric, and are components, subassemblies, and semi-fabricated materials to be specified in metric units when economically available and technically adequate? Will A.I.D. specifications use metric units of measure from the earliest programmatic stages, and from the earliest Yes.

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documentation of the assistance processes (for example, project papers) involving quantifiable measurements (length, area, volume, capacity, mass and weight), through the implementation stage?

1. **Competitive Selection Procedures** (FAA Sec. 601(e)): Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? — Yes.

23. **Construction**

a. **Capital project** (FAA Sec. 601(d)): If capital (e.g., construction) project, will U.S. engineering and professional services be used? — N/A.

b. **Construction contract** (FAA Sec. 611(c)): If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable? — N/A.

c. **Large projects, Congressional approval** (FAA Sec. 620(k)): If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed $100 million (except for productive enterprises in Egypt that were described in the Congressional Presentation), or does assistance have the express approval of Congress? — N/A.

24. **U.S. Audit Rights** (FAA Sec. 301(d)): If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights? — N/A.

25. **Communist Assistance** (FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries? — Yes.

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26. **Narcotics**

a. **Cash reimbursements** (FAA Sec. 483): Will arrangements preclude use of financing to make reimbursements, in the form of cash payments, to persons whose illicit drug crops are eradicated?

Yes.

b. **Assistance to narcotics traffickers** (FAA Sec. 487): Will arrangements take "all reasonable steps" to preclude use of financing to or through individuals or entities which we know or have reason to believe have either: (1) been convicted of a violation of any law or regulation of the United States or a foreign country relating to narcotics (or other controlled substances); or (2) been an illicit trafficker in, or otherwise involved in the illicit trafficking of, any such controlled substance?

Yes.

27. **Expropriation and Land Reform** (FAA Sec. 620(g)): Will assistance preclude use of financing to compensate owners for expropriated or nationalized property, except to compensate foreign nationals in accordance with a land reform program certified by the President?

Yes.

28. **Police and Prisons** (FAA Sec. 660): Will assistance preclude use of financing to provide training, advice, or any financial support for police, prisons, or other law enforcement forces, except for narcotics programs?

Yes.

29. **CIA Activities** (FAA Sec. 662): Will assistance preclude use of financing for CIA activities?

Yes.

30. **Motor Vehicles** (FAA Sec. 636(i)): Will assistance preclude use of financing for purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained?

No purchase of vehicle is contemplated, but if applicable, a waiver will be obtained.

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31. **Military Personnel** (FY 1991 Appropriations Act Sec. 503): Will assistance preclude use of financing to pay pensions, annuities, retirement pay, or adjusted service compensation for prior or current military personnel?

Yes.

32. **Payment of U.N. Assessments** (FY 1991 Appropriations Act Sec. 505): Will assistance preclude use of financing to pay U.N. assessments, arrearages or dues?

Yes.

33. **Multilateral Organization Lending** (FY 1991 Appropriations Act Sec. 506): Will assistance preclude use of financing to carry out provisions of FAA section 209(d) (transfer of FAA funds to multilateral organizations for lending)?

Yes.

34. **Export of Nuclear Resources** (FY 1991 Appropriations Act Sec. 510): Will assistance preclude use of financing to finance the export of nuclear equipment, fuel, or technology?

Yes.

35. **Repression of Population** (FY 1991 Appropriations Act Sec. 511): Will assistance preclude use of financing for the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights?

Yes.

36. **Publicity or Propoganda** (FY 1991 Appropriations Act Sec. 516): Will assistance be used for publicity or propaganda purposes designed to support or defeat legislation pending before Congress, to influence in any way the outcome of a political election in the United States, or for any publicity or propaganda purposes not authorized by Congress?

Yes.

37. **Marine Insurance** (FY 1991 Appropriations Act Sec. 563): Will any A.I.D. contract and solicitation, and subcontract entered into under such contract, include a clause requiring that U.S. marine insurance companies have a fair opportunity to bid for marine insurance when such insurance is necessary or appropriate? Yes.

38. **Exchange for Prohibited Act** (FY 1991 Appropriations Act Sec. 569): Will any assistance be provided to any foreign government (including any instrumentality or agency thereof), foreign person, or United States person in exchange for that foreign government or person undertaking any action which is, if carried out by the United States Government, a United States official or employee, expressly prohibited by a provision of United States law? No.

B. CRITERIA APPLICABLE TO DEVELOPMENT ASSISTANCE ONLY

1. **Agricultural Exports (Bumpers Amendment)** (FY 1991 Appropriations Act Sec. 521(b), as interpreted by conference report for original enactment): If assistance is for agricultural development activities (specifically, any testing or breeding feasibility study, variety improvement or introduction, consultancy, publication, conference, or training), are such activities: (1) specifically and principally designed to increase agricultural exports by the host country to a country other than the United States, where the export would lead to direct competition in that third country with exports of a similar commodity grown or produced in the United States, and can the activities reasonably be expected to cause substantial injury to U.S. exporters of a similar agricultural commodity; or (2) in support of research that is intended primarily to benefit U.S. producers? N/A

2. **Tied Aid Credits** (FY 1991 Appropriations Act, Title II, under heading "Economic Support Fund"): Will DA funds be used for tied aid credits?

3. **Appropriate Technology** (FAA Sec. 107): Is special emphasis placed on use of appropriate technology (defined as relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

Yes. Where TA is given to individual firms, appropriate technology usage will be stressed.

4. **Indigenous Needs and Resources** (FAA Sec. 281(b)): Describe extent to which the activity recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civic education and training in skills required for effective participation in governmental and political processes essential to self-government.

The project is designed to strengthen the business community of Nepal, through improved business operations and a regulatory framework beneficial to the private sector. Assistance will be "demand driven" by the private sector itself.

5. **Economic Development** (FAA Sec. 101(a)): Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

Yes. This is the

6. **Special Development Emphases** (FAA Secs. 102(b), 113, 281(a)): Describe extent to which activity will: (a) effectively involve the poor in development by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, dispersing investment from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using appropriate U.S. institutions; (b) encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries

a. Poor and middle class business people are the targets of the project for assistance. Most business is essentially rural, although most industry is urban. This will not change.

b. Activities are democratic by nature.

c. This is a self-help, demand driven project.

d. Women participation is key to a well-rounded balanced assistance effort.

and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries.

Trade linkages with the region will be encouraged.

7. **Recipient Country Contribution** (FAA Secs. 110, 124(d)): Will the recipient country provide at least 25 percent of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)?

A waiver is being requested, as the Government of Nepal's direct contribution will be small.

8. **Benefit to Poor Majority** (FAA Sec. 128(b)): If the activity attempts to increase the institutional capabilities of private organizations or the government of the country, or if it attempts to stimulate scientific and technological research, has it been designed and will it be monitored to ensure that the ultimate beneficiaries are the poor majority?

The beneficiaries of the project include the poor majority, but principally as indirect beneficiaries. Direct beneficiaries are business people, their families and employees.

9. **Abortions** (FAA Sec. 104(f); FY 1991 Appropriations Act, Title II, under heading "Population, DA," and Sec. 535):

a. Are any of the funds to be used for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions?

b. Are any of the funds to be used to pay for the performance of involuntary sterilization as a method of family planning or to coerce or provide any financial incentive to any person to undergo sterilizations?

c. Are any of the funds to be made available to any organization or program which, as determined by the President, supports or participates in the management of a program of coercive abortion or involuntary sterilization?

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d. Will funds be made available only to voluntary family planning projects which offer, either directly or through referral to, or information about access to, a broad range of family planning methods and services? — No.

e. In awarding grants for natural family planning, will any applicant be discriminated against because of such applicant's religious or conscientious commitment to offer only natural family planning? — N/A.

f. Are any of the funds to be used to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning? — No.

g. Are any of the funds to be made available to any organization if the President certifies that the use of these funds by such organization would violate any of the above provisions related to abortions and involuntary sterilization?

10. **Contract Awards** (FAA Sec. 601(e)): Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? — Yes.

11. **Disadvantaged Enterprises** (FY 1991 Appropriations Act Sec. 567): What portion of the funds will be available only for activities of economically and socially disadvantaged enterprises, historically black colleges and universities, colleges and universities having a student body in which more than 40 percent of the students are Hispanic Americans, and private and voluntary organizations which are controlled by individuals who are black Americans, Hispanic Americans, or Native Americans, or who are economically or socially disadvantaged (including women)? — Conceivably, but no arbitrary level of funds is being set aside.

12. **Biological Diversity** (FAA Sec. 119(g): Will the assistance: (a) support training and education efforts which improve the capacity of recipient countries to prevent loss of biological diversity; (b) be provided under a long-term agreement in which the recipient country agrees to protect ecosystems or other wildlife habitats; (c) support efforts to identify and survey ecosystems in recipient countries worthy of protection; or (d) by any direct or indirect means significantly degrade national parks or similar protected areas or introduce exotic plants or animals into such areas?

No. Other activities in the Mission's portfolio address these concerns.

13. **Tropical Forests** (FAA Sec. 118; FY 1991 Appropriations Act Sec. 533(c)-(e) & (g)):

a. **A.I.D. Regulation 16:** Does the assistance comply with the environmental procedures set forth in A.I.D. Regulation 16?

Yes.

b. **Conservation:** Does the assistance place a high priority on conservation and sustainable management of tropical forests? Specifically, does the assistance, to the fullest extent feasible: (1) stress the importance of conserving and sustainably managing forest resources; (2) support activities which offer employment and income alternatives to those who otherwise would cause destruction and loss of forests, and help countries identify and implement alternatives to colonizing forested areas; (3) support training programs, educational efforts, and the establishment or strengthening of institutions to improve forest management; (4) help end destructive slash-and-burn agriculture by supporting stable and productive farming practices; (5) help conserve forests which have not yet been degraded by helping to increase production on lands already cleared or degraded; (6) conserve forested watersheds and rehabilitate those which have been deforested; (7) support training, research, and other actions

Except where assistance will be given directly to a productive industry a categorial exclusion was grantea.

which lead to sustainable and more environmentally sound practices for timber harvesting, removal, and processing; (8) support research to expand knowledge of tropical forests and identify alternatives which will prevent forest destruction, loss, or degradation; (9) conserve biological diversity in forest areas by supporting efforts to identify, establish, and maintain a representative network of protected tropical forest ecosystems on a worldwide basis, by making the establishment of protected areas a condition of support for activities involving forest clearance or degradation, and by helping to identify tropical forest ecosystems and species in need of protection and establish and maintain appropriate protected areas; (10) seek to increase the awareness of U.S. Government agencies and other donors of the immediate and long-term value of tropical forests; (11) utilize the resources and abilities of all relevant U.S. government agencies; (12) be based upon careful analysis of the alternatives available to achieve the best sustainable use of the land; and (13) take full account of the environmental impacts of the proposed activities on biological diversity?

N/A.

N/A.

c. **Forest degradation:** Will assistance be used for: (1) the procurement or use of logging equipment, unless an environmental assessment indicates that all timber harvesting operations involved will be conducted in an environmentally sound manner and that the proposed activity will produce positive economic benefits and sustainable forest management systems; (2) actions which will significantly degrade national parks or similar protected areas which contain tropical forests, or introduce exotic plants or animals into such areas; (3) activities which would result in the conversion of forest lands to the rearing of livestock; (4) the construction, upgrading, or maintenance of roads (including temporary haul roads for logging or other extractive industries) which pass through relatively undergraded

No.

No.

No.

No.

qb

forest lands; (5) the colonization of forest lands; or (6) the construction of dams or other water control structures which flood relatively undergraded forest lands, unless with respect to each such activity an environmental assessment indicates that the activity will contribute significantly and directly to improving the livelihood of the rural poor and will be conducted in an environmentally sound manner which supports sustainable development? No. No.

d. **Sustainable forestry:** If assistance relates to tropical forests, will project assist countries in developing a systematic analysis of the appropriate use of their total tropical forest resources, with the goal of developing a national program for sustainable forestry? N/A.

e. **Environmental impact statements:** Will funds be made available in accordance with provisions of FAA Section 117(c) and applicable A.I.D. regulations requiring an environmental impact statement for activities significantly affecting the environment? Yes.

14. **Energy** (FY 1991 Appropriations Act Sec. 533(c)): If assistance relates to energy, will such assistance focus on: (a) end-use energy efficiency, least-cost energy planning, and renewable energy resources, and (b) the key countries where assistance would have the greatest impact on reducing emissions from greenhouse gases? N/A.

15. **Sub-Saharan Africa Assistance** (FY 1991 Appropriations Act Sec. 562, adding a new FAA chapter 10 (FAA Sec. 496)): If assistance will come from the Sub-Saharan Africa DA account, is it: (a) to be used to help the poor majority in Sub-Saharan Africa through a process of long-term development and economic growth that is equitable, participatory, environmentally sustainable, and self-reliant; (b) to be used to promote sustained economic growth, encourage N/A.

private sector development, promote individual initiatives, and help to reduce the role of central governments in areas more appropriate for the private sector; (c) to be provided in a manner that takes into account, during the planning process, the local-level perspectives of the rural and urban poor, including women, through close consultation with African, United States and other PVOs that have demonstrated effectiveness in the promotion of local grassroots activities on behalf of long-term development in Sub-Saharan Africa; (d) to be implemented in a manner that requires local people, including women, to be closely consulted and involved, if the assistance has a local focus; (e) being used primarily to promote reform of critical sectoral economic policies, or to support the critical sector priorities of agricultural production and natural resources, health, voluntary family planning services, education, and income generating opportunities; and (f) to be provided in a manner that, if policy reforms are to be effected, contains provisions to protect vulnerable groups and the environment from possible negative consequences of the reforms?

16. **Debt-for-Nature Exchange (FAA Sec. 463):** If project will finance a debt-for-nature exchange, describe how the exchange will support protection of: (a) the world's oceans and atmosphere, (b) animal and plant species, and (c) parks and reserves; or describe how the exchange will promote: (d) natural resource management, (e) local conservation programs, (f) conservation training programs, (g) public commitment to conservation, (h) land and ecosystem management, and (i) regenerative approaches in farming, forestry, fishing, and watershed management.

N/A

a

17. **Deobligation/Reobligation** (FY 1991 Appropriations Act Sec. 515): If deob/reob authority is sought to be exercised in the provision of DA assistance, are the funds being obligated for the same general purpose, and for countries within the same region as originally obligated, and have the House and Senate Appropriations Committees been properly notified? N/A.

18. **Loans**

a. **Repayment capacity** (FAA Sec. 122(b)): Information and conclusion on capacity of the country to repay the loan at a reasonable rate of interest. N/A.

b. **Long-range plans** (FAA Sec. 122(b)): Does the activity give reasonable promise of assisting long-range plans and programs designed to develop economic resources and increase productive capacities?

c. **Interest rate** (FAA Sec. 122(b)): If development loan is repayable in dollars, is interest rate at least 2 percent per annum during a grace period which is not to exceed ten years, and at least 3 percent per annum thereafter? N/A

d. **Exports to United States** (FAA Sec. 620(d)): If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20 percent of the enterprise's annual production during the life of the loan, or has the requirement to enter into such an agreement been waived by the President because of a national security interest? N/A

19. **Development Objectives** (FAA Secs. 102(a), 111, 113, 281(a)): Extent to which activity will: (1) effectively involve the poor in development, by expanding access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from

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cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (2) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (3) support the self-help efforts of developing countries; (4) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (5) utilize and encourage regional cooperation by developing countries?

20. **Agriculture, Rural Development and Nutrition, and Agricultural Research** (FAA Secs. 103 and 103A):

a. **Rural poor and small farmers:** If assistance is being made available for agriculture, rural development or nutrition, describe extent to which activity is specifically designed to increase productivity and income of rural poor; or if assistance is being made available for agricultural research, has account been taken of the needs of small farmers, and extensive use of field testing to adapt basic research to local conditions shall be made. N/A

b. **Nutrition:** Describe extent to which assistance is used in coordination with efforts carried out under FAA Section 104 (Population and Health) to help improve nutrition of the people of developing countries through encouragement of increased production of crops with greater nutritional value; improvement of planning, research, and education with respect to nutrition, particularly with reference to improvement and expanded use of indigenously produced foodstuffs; and the undertaking of pilot or demonstration programs explicitly addressing the problem of malnutrition of poor and vulnerable people. N/A

c. **Food security:** Describe extent to which activity increases national food security by improving food policies and management and by strengthening national food reserves, with particular concern for the needs of the poor, through measures encouraging domestic production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution. N/A

21. **Population and Health** (FAA Secs. 104(b) and (c)): If assistance is being made available for population or health activities, describe extent to which activity emphasizes low-cost, integrated delivery systems for health, nutrition and family planning for the poorest people, with particular attention to the needs of mothers and young children, using paramedical and auxiliary medical personnel, clinics and health posts, commercial distribution systems, and other modes of community outreach. N/A

22. **Education and Human Resources Development** (FAA Sec. 105): If assistance is being made available for education, public administration, or human resource development, describe (a) extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, and strengthens management capability of institutions enabling the poor to participate in development; and (b) extent to which assistance provides advanced education and training of people of developing countries in such disciplines as are required for planning and implementation of public and private development activities. N/A

23. **Energy, Private Voluntary Organizations, and Selected Development Activities** (FAA Sec. 106): If assistance is being made available for energy, private voluntary organizations, and selected development problems, describe extent to which activity is:

a. concerned with data collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy production; and facilitative of research on and development and use of small-scale, decentralized, renewable energy sources for rural areas, emphasizing development of energy resources which are environmentally acceptable and require minimum capital investment;

Project is directly aimed at business skills strengthening and competitive market development and contains elements of market research, works with PVO's, macro and microeconomics, policy reform. Targeted are the general business community and GON regulatory bodies and key decision-makers.

b. concerned with technical cooperation and development, especially with U.S. private and voluntary, or regional and international development, organizations;

see above

c. research into, and evaluation of, economic development processes and techniques;

see above

d. reconstruction after natural or manmade disaster and programs of disaster preparedness;

N/A

e. for special development problems, and to enable proper utilization of infrastructure and related projects funded with earlier U.S. assistance;

N/A

f. for urban development, especially small, labor-intensive enterprises, marketing systems for small producers, and financial or other institutions to help urban poor participate in economic and social development.

see above

ANNEX F

Training Plan

Each project activity contains separate training programs, both formal and on-the-job. Training can be categorized by locale, permanence, trainers and trainees, academic or technical, etc... The project is self-limiting to non-degree training which is targeted at specific, well-defined needs and problems. The bulk of training will be carried out from FY92-FY96. The following plan is organized by component and activity, year and number of courses/no. participants per course. For each type of training, by year, the number of courses and participants per course are shown, i.e. 4/20 signifies four courses with twenty participants in each course. The first column describes the course, place, and duration. In the following columns, U.S. connotes training in U.S., R in region, L. connotes local training.

Course	FY 1992		FY 1993		FY 1994		FY 1995		Total person month
I. Local Institutions									
A. Study Tours in U.S. & region, 3 weeks	US 2/6		US	-	US 2/6			-	18 pm
B. Management & Public Relations in region, 2 weeks	R 12/1		R 12/1		R 24/1		R 24/1		24 pm
II. Business Skill Training									
A. Management in region and local, 2 weeks	R 2/4	L 4/15	R 2/4	L 4/15	R 2/4	L 4/15	R 2/4	L 4/15	136 pm
B. Finance and Accounting local	-	L 4/15	-	4/15	-	4/15	-	4/15	60 pm
C. Production, U.S. and local, 1 month	US 3/1	L 4/5	US 3/1	L 4/5	US 3/1	L 4/5	US 3/1	4/5	92 pm
D. Personnel/public relations, local for 1 week	-	L 2/15	-	L 2/15	-	L 2/15	-	L 2/15	30 pm
E. Credit/Equity instruments in US and local, 1 month and 2 weeks respectively	US 2/3	L 2/15	US 2/3	L 2/15	US 2/3	L 2/15	US 2/3	L 2/15	54 pm
III. Trade Support									
A. Study tours, in US & region, 3 weeks	US 2/6		US 2/6		US 2/6		US 2/6		36 pm
B. Trade fair participation, US & region, 3 weeks	US 2/4		US 2/4		US 2/4		US 2/4		24 pm
C. Skills training (production), local, 2 weeks	L 2/20		L 2/20		L 2/20		L 2/20		80 pm

ANNEX F-2

Course	FY 1992	FY 1993	FY 1994	FY 1995	Total person month
IV. Regulatory Environment					
A. Cost/Benefit Analysis, local, 2 weeks	L 2/15	L 2/15	L -	L -	30 pm
B. Decentralized seminars, local, 2 weeks	L 2/15	L 2/15	L 2/15	L 2/15	60 pm
C. Regulation and workshop, local, 1 week	L 1/20	L 1/20	L 1/20	L 1/20	20 pm
D. Implementer Training Workshops, local, 1/2 week	L 2/20	L 2/20	L 2/20	L 2/20	20 pm
V. Open Entry System					
A. Credit Union training, local, 2 weeks	L 2/20	L 2/20	L 2/20	L 2/20	80 pm
B. HFDC finance & management, US & region, 2 weeks	US 2/2	R 2/2	US 2/2	R 2/2	16 pm
C. Financial instrument seminars, local, 1 week	L 2/20	L 2/20	L 2/20	L 2/20	40 pm
D. Bank examination, loan appraisal seminars, local, 2 weeks	L 1/20	L 1/20	L 1/20	L 1/20	20 pm

ANNEX G

PROMOTING ENTREPRENEURSHIP
OPTIONS FOR REFORMS

WORKSHOP REPORT

(April 12, 1991)

Prepared by :

Human Resource Development Centre (HURDEC)
Kathmandu

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PROMOTING ENTREPRENEURSHIP : OPTIONS FOR REFORMS

WORKSHOP REPORT

BACKGROUND

For democracy in Nepal to be sustainable, it is essential that the private sector be promoted and developed. In this context, the last three decades of development in Nepal have shown that instead of facilitating growth of the private sector, HMG is perceived as having become an impediment.

In this context, Institutional Reform and the Informal Centre (IRIS) Centre, University of Maryland with the cooperation of Nepalese professionals conducted a study in late 1990 to identify issues which were acting as bottlenecks to the growth of Nepalese private sector. Among the various issues identified, three were taken up as priority issues that the new government after the May 12 elections could start working on. These three areas were :

1. Business Registration
2. Taxation
3. Access to Capital

In order to present the findings of the IRIS study and to have an open discussion about these issues, IRIS Centre and USAID/Nepal funded the implementation of a workshop in Kathmandu on April 12, 1991. The sponsors of this program were Rotary Club of Kathmandu Mid-Town, Nepal Chamber of Commerce and the Nepal Jaycees.

The participants invited for this workshop were representatives of the private sector, banks and related HMG agencies. The list of participants are given in Annex 1 of this report.

OBJECTIVES OF THE WORKSHOP

The objectives of the workshop are as follows :

1. To discuss issues raised by the Option Paper and to prioritize them in order of importance;

2. To come up with concrete actions that must be taken by the concerned authorities;

3. To identify a core group that would be responsible for the follow-up and implementation of the recommendations made in the workshop.

THE METHODOLOGY

In order to attain the objectives in this one-day workshop, the the workshop was conducted in the following manner. The breakout sessions were conducted using the METAPLAN technique, which is a method to ensure participation of all as well as facilitate the visualization of the findings.

The workshop schedule was as follows :

8.30 Opening of Workshop - Welcome Remarks by Badri Das Shrestha (Jaycees) and IRIS Program Director.

Presentation of paper by Surendra Adhikari

9.15 Tea Break

9.30 Presentation of summary of findings on the options selected.
(Each paper was be presented by representatives of sponsoring agencies)

a. Business Registration - Pushkar M.Shakya (JC)
b. Taxation - Roop Jyoti (Rotary)
c. Access to Capital - B. Mittal (NCC)

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10.30	Group Work
12.30	LUNCH BREAK
13.30	Group Discussions continue
15.00	TEA BREAK
15.15	Group Discussion on Follow-up Mechanism
16.15	Presentation of Group Recommendations and Discussions by representative of each working group
	Ballot on priorities of the participants
17.30	Workshop Closing - Remarks by HMG and Nepal Chamber of Commerce Representatives
19.00	Press Conference and Reception

WORKSHOP PROCEEDINGS

The next part of the report describes the discussions that took place in each of the smaller groups. The group discussions were structured in the following manner using the METAPLAN technique.

1. Major problem areas
2. Recommendations
3. Responsibility for follow-up.

Annex 2 contains the findings of the ballot as to the most important areas of concern of the participants.

BUSINESS REGISTRATION

The MAIN PROBLEMS identified by the participants were :

1. Lack of information and knowledge

   a. Businessmen do not fully understand the significance of registration forms

   b. Registration forms are not completely filled

   c. Absence of manuals on how to fill forms

2. Lengthy process

   a. Time taking and cumbersome process

   b. Lengthy registration process for a limited company in the Department of Commerce

   c. Decision is delayed

   d. Need to reduce number of forms

   e. Unnecessary paper work

   f. Too much paper work when subsidies and facilities are sought

   g. Due to limitation of national policies, there is too much paper work

   h. Lengthy registration process in the Income Tax Department

3. Under-table money transactions

   a. Files do not move without under table money to staff

   b. Need for under table money for registration

4. License related issues

   a. Too many licenses are issued thereby making it difficult for companies to run profitably

   b. Licenses of Commerce Department are black marketed

5. Attitude related issues

   a. Uncooperative attitude of government staff

   b. Entrepreneurs not treated as clients in registration offices

   c. It is necessary to lie to get foreign currency for raw materials

In order to solve the above mentioned problems, the participants came up with the following <u>RECOMMENDATIONS</u> :

1. There should be a single office for all types of registration formalities so that firms can be registered legally

2. For licensing and other facilities, concerned departments and offices should be made responsible

3. There should be regular information dissemination by HMG offices with regards to rules and regulations concerning registration

4. Training must be provided to HMG staff and businessmen

5. There must be a manual describing formalities required for registering a business

6. HMG and the private sector must meet regularly to discuss rules and regulations regarding registration

7. There must be regular review and revision to simplify forms and procedures for registration

8. Forum should be established for HMG and private sector to jointly discuss matters related to registration and licensing

For <u>FOLLOW-UP</u> of the recommendations, the participants agreed on the following :

1. Policy guidelines should be provided by a task force comprising of Nepal Chamber of Commerce and Jaycees representatives

2. Implementation and follow-up must be done by private sector consulting firm(s)

3. Small Business Promotion Project (SBPP) should take initiative for providing information on the problems of cottage and small scale industries.

ACCESS TO CAPITAL

The MAIN PROBLEMS which were identified were :

1. Problems of loan procedure

   a. Difficult procedures to get loans from banks

   b. Cumbersome loan application process and inapproprite valuation

   c. Delay in loan processing

   d. Lack of loan collection enforcement

   e. Collateral requirements for even good projects

2. Capital market related issues

   a. Insufficient competition in the banking sector

   b. Almost no private sector banks outside Kathmandu

   c. Lack of adequate capital market

   d. Lack of competitors in long term financing

3. Inadequate information on access and use of credits

   a. Absence of bankable projects

   b. Lack of information on bakable/feasible projects

   c. Credit goes to wrong use

   d. Credit goes to wrong people

   f. Nepal Chamber of Commerce and FNCCI does not provide guidelines to its members seeking loan

4. Problems related to HMG policies and practices

   a. Too much control of Ministry of Finance

   b. Impractical policies of HMG

   c. Inconsistent policies of financial institutions

   d. Loans approved by banks should not be subject to government review

   f. Lack of understanding among HMG, Nepal Rastra Bank and clients

   g. High interest rates (creation of cartel)

   h. Contradictory classification by National Planning Commission and Nepal Rastra Bank

5. Problems related to access to loans

   a. Lack of innovativeness in accepting collateral

   b. Lack of risk or equity capital

   c. Underfinancing by banks

   d. Lack of venture capital

   e. Debt servicing requirements of banks is not conducive for new entrepreneurs and small scale businessmen

   f. High equity requirements

   g. Low foreign currency facilities to industrial sector

   h. Lack of access to capital for new entrepreneurs

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RECOMMENDATIONS made by the participants are as follows :

1. Information access must be done in the following ways :

   a. Banks should have one customer service wing to cordinate and provide information to in-coming clients

   b. There should be appropriate valuation of loan applications, and new or extended application for capacity expansion

   c. There should be no undue delay in loan sanctioning if the collateral is adequate and all processes have been completed

   d. Assist entrepreneurs who seek information on how to apply for a loan (one possibility is to share information and the costs with the Chamber)

   e. Establish and publish information on procedures for applying for loans, making the process transparent

2. Procedure simplification must be done by :

   a. Similar types of forms can be removed, only one form with all details should be filled out

   b. Make samples available so that entrepreneurs can have examples of form filling

3. Access to loan (collateral and venture capital)

   a. Banks should provide risk capital in the form of common or preference shares to meet risk capital shortage of the promoters

   b. Banks should provide upto 70% of the project cost (fixed cost and permanent working capital), which will help to alleviate capital shortage

c. Project financing system should be developed in the old commercial banks

d. Sell off bad loans for collection or redressment

e. Foreign currency needed by viable industries should be provided without delay and without lengthy process

f. Credit guarantee funds at local level should be made available

g. Network of cooperative banks should be established for industry

h. Banks should not ask for additional collateral or personal gurantees for projects where promoter maintains less than 50% shareholding

i. Loan process should be simplified

j. Project collateral should be acceptable to banks

k. Introduce alternatives to private limited as far as liability is concerned

l. For small borrower financing, related and unrelated collateral should not exceed 2 times the loan size

4. **HMG related issues**

a. Reform foreign exchange allocation procedure for machinery and raw materials

b. Rules and regulations must be amended to become more suitable for promotion of businesses

c. HMG must take steps to promote more financial institutions for financing industries

d. There should be a system whereby Ministry of Finance is only informed, and foreign investors, donors etc, can make direct investments in Nepal

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For FOLLOW-UP, the group recommended the following :

1. A small group consisting of representatives of Chambers and other associations must be formed for follow-up activities and implementation of the workshop recommendations

TAXATION

The MAIN PROBLEMS identified by the group were :

1. Income Tax related :

   a. Assessment problems as there is no scientific criteria and rates are too high

   b. Tax holiday is not available in reality

   c. Absence of system for evaluation of family income

   d. Tax rate for personal income tax has not been reduced

   e. Tendency to raise income tax from existing tax payers. No attempt is made to increase the number of tax payers

   f. Lack of adequate tax administration

   g. Impractical method to accept genuine expenses

   h. Lack of clarity in rules and regulations

   i. Lack of information on taxes

   j. HMG's presumption that all businesses have necessarily made profits is wrong and baseless

   k. Because of the practice of bribes, there is more bribes paid than the amount to HMG as tax

   l. Tax registration system is used as a means to force people and businesses to pay taxes

2. Excise Tax related :

   a. Too difficult to cha e rices on which excise is to be paid - declining ices are not acceptable

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3. Wealth Tax related :

   a. Introduction of wealth tax will not be beneficial for existing tax payers

4. General issues :

   a. Property transfer tax is so high that it has led to manipulations and other such practices

   b. Contracting is not considered as a service industry and thus it does not have facilities as provided to other industries

Based on these problems, the group made the following RECOMMENDATIONS :

1. Need for development of visible criteria for taxation and tax assessment

2. Need to develop tax manuals

3. Tax officers should not base their assessment only to fulfill their targets

4. For tax holidays and other facilities, there should be no need to run around to several HMG offices

5. Turnover tax should be abolished

6. Rules must be simplified and made clear-cut

7. Steps must be taken to revise the unrealistic expenses limits currently in use bt the Tax authorities

8. A revenue service group should be established and those involved in this service should be allowed to function without threats

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9. Arbitrariness in issues related to local purchase must be removed

10. Because of the open border, there is need to reduce custom duties so that smuggling can be discouraged

11. There is need to have more trust on the returns submitted by tax payers

13. For small tax payers, there is need to have on-the-spot assessment

14. Regular monitoring is required on prices for the purpose of excise and sales tax

15. Customs facilities given to industries should also be applicable to the service sector

16. Wealth tax is not timely as it will have adverse impact on savings and investment

17. Property transfer tax rate must be reduced

18. Foreign companies who import duty free items for specific uses must not be allowed to use them for any other purposes. If this is not done then local producers are affected. There must be provision that after the specified time, either duty is paid on these items or they are confiscated.

In order to implement these recommendations, the group suggested that the following be done for <u>FOLLOW-UP</u> :

1. FNCCI and NCC should take the lead role

2. An institutional mechanism be set up in which private sector experts must work with businessmen and HMG to follow-up these recommendations.

ANNEX 1

LIST OF PARTICIPANTS IN EACH GROUP

BUSINESS REGISTRATION

	NAME	ORGANIZATION
1.	K. C. Shrestha	Department of Commerce
2.	B. K. L. Joshi	UNDP
3.	S. B. Malakar	Nepal Chamber of Commerce(NCC)
4.	R. K. Shrestha	NCC
5.	Ashok Man Singh	Small Business Promotion Project
6.	Khusru Manekshaw	Rotary Club Mid-Town
7.	Dr. B. N. Chalise	Ministry of Industry
8.	Sunny Harjani	Rotary Club Mid-Town
9.	Kuldharma R. Tuladhar	NCC
10.	Ganesh Dhungana	Nepal Jaycees
11.	S. Bajracharya	USAID/Nepal

TAXATION

1.	Suraj Vaidya	Vaidya Group of Industries
2.	Ramesh Sharma	Carpet Association of Nepal
3.	Kishor Pandey	Private Sector
4.	P. Rajbhandari	Nepal Jaycees
5.	Krishna Paudyal	Nepal Rastra Bank
6.	D. C. Shakha	Nepal Jaycees
7.	S. R. Kayastha	" "
8.	H. M. Shrestha	Private Sector
9.	R. Thapaliya	Private Sector
10.	Vijay Dugar	Rotary Club of Mid-Town
11.	Dwarika B. Pradhananga	NCC
12.	Bharat Joshi	NJC
13.	R. R. Shrestha	NJC
14.	Suresh Joshi	NJC
15.	Babin	NJC

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ACCESS TO CAPITAL

1.	P. M. Ghmire	Private Sector
2.	B. L. Shrestha	NCC
3.	B. K. Bhattarai	Private Sector
4.	A. R. Sthapit	Private Sector
5.	A. R. Parajuli	Indo Suez Bank
6.	A. N. S. Thapa	NIDC
7.	L. G. Shrestha	Nepal Foreign Trade Association
8.	G. D. Pandey	Cottage Industry Development Board
9.	K. Lamichhane	NJC
10.	S. Rijal	NJC
11.	Badri Shrestha	NJC
12.	M. Bhattarai	Association of Nepal Cottage and Small Scale Industries
13.	M. K. Shrestha	" "
14.	R. Azeliya	NJC
15.	B. D. Joshi	NABIL Bank
16.	R. Guthier	SBPP
17.	K. Surana	NJC
18.	S. Bhattarai	NJC
19.	S. B. Adhikari	Nepal Rastra Bank

ANNEX 2

PARTICIPANTS' PERCEPTION OF THE MOST CRUCIAL ISSUES

A secret ballot was provided at the end of the workshop to each of the participants and they were asked to list the three most important issues in their perception. These were to be chosen from all the issues that were raised by the participants during the workshop discussions.

The listing is made based on the priorities of the workshop participants.

1. Tax assessment problems
2. Lack of information on business registration
3. Defects in HMG policies with regards to capital
4. Collateral related issues in seeking loans
5. Lengthy registration process
6. Problems of access to loan
7. Lack of skills among HMG officials in tax administration

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VII. ANALYSES

ANALYSIS A

A. Economic Considerations

The Economic Liberalization Project is a cost effective way to use scarce U.S. and Nepali resources to achieve project goals. Because the analysis of liberalization deals with global estimates and generic interventions, the project will have to monitor the performance of each intervention to ascertain economic effectiveness and which approaches are cost-effective. Alternative methods of delivering project services were analyzed, and the most efficient selected (for example, working with trade associations rather than individual firms, because most enterprises are too small to justify spending expensive foreign technical assistance on one firm). By providing the assistance to a group of firms, whether organized around an association or some other informal method, will reduce the cost per firm. Similarly the project will use those Nepali enterprises that have learned how to market internationally to teach those just beginning to consider export. The project must monitor implementation to determine whether the benefits are still sufficient.

Another example of using cost-effective methods is to use in-country training whenever the cost of sending the people to the US exceeds the cost of bringing the trainers to Nepal (unless there are substantial benefits derived from contact with people from other developing countries). Training will also emphasize using facilities on the sub-continent or elsewhere in Asia whenever they are cost effective. Follow-up and monitoring of those sent overseas will increase the probability that the training is used as envisioned.

Through detailed analysis it was possible to derive benefit-cost ratios for specific project interventions such as; implementing new financial tools and institutions, deregulation, and privatization. There are many assumptions in the analysis that shall have to be verified with implementation.

Economic liberalization that has begun in India provides a model and an incentive to Nepal. While there is no assurance that India's efforts will continue, it has taken a number of concrete steps that indicate a level of support for liberalization that did not exist before.

Before India began its efforts, Nepal still had the luxury of following the Indian example and taking advantage of the economic foibles of India. If India continues with its efforts, then Nepal has no choice but to liberalize. The Nepali economy is not large enough to support subsidies and inefficiencies, nor is the market large enough to justify production strictly for the Nepali market. Unless Nepal changes the way it determines the exchange rate, the Indian movement toward a hard currency will result in a hard currency in Nepal. Since most of the rules and regulations controlling business activity in Nepal exist because of the need to control foreign exchange, many of these rules can be eliminated. Nepali officials have not thought through the implications of India's moves, what they must do, how it ought to be done, and what alternatives exist. The alternatives of a few weeks ago have been changed: we now have alternative modes of liberalization, not of state control.

Indian liberalization will eliminate the basis of the Nepali smuggling and assembly industry. Nepal will have to develop a firmer base for industrial activity using real economic advantages in Nepal. In short, the economic analysis concludes that Nepal must follow "pari passu" India's liberalization, or get ahead of India.

Nepal's current economic relationship with India has benefitted both countries, but it too must change with liberalization. The analysis concludes that the current preferential regime leads to serious trade diversion, resulting in higher prices and lower tariff collections in Nepal. With lower effective rates of protection and liberalization in India, the rationale for a two-tier import duty structure is lost. Nepal can and ought to move toward an most favored nation (MFN) regime to permit trade based on real economic prices.

The Economic Liberalization Project has high risks. However, senior government officials, from the Prime Minister down, have an increased recognition of the necessity of liberalization. The bureaucracy and entrenched, vested interests will resist changes. Low government salaries have necessitated sale of government forms and signatures. Many civil servants cannot afford to relinquish these benefits: some institutions will fight reform. The Project was designed to be exceptionally flexible and undertake different types of liberalization activities so long as they led to an open, competitive, private sector-led market economy. Even if only a few of the reforms the project seeks can be implemented, then the value of the resulting benefits to the economy are sufficient to make the project an economically justifiable use of scarce resources.

<u>Project Objectives</u>

The objective of the project is to help create an environment where an open, competitive, private sector led, market economy can thrive. Only in these circumstances can the economy grow in a sustainable way and generate not only additional jobs, but needed foreign exchange and tax revenue to finance government programs and remain within Structural Adjustment deficit and domestic borrowing limits.

In a broader sense, the project also aims at expansions in jobs, income and exports, plus improvement in government's revenue

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generation capability. To do this the project will work with government and business community to develop a climate conducive to private sector development, and then to assist the private sector in taking advantage of the improved environment. The project does not aim to purchase policy change through the provision of resources to effect the change, but rather to work with decision makers and convince them of the efficacy of the change. In some cases, a major change can be made with the provision of very limited financial resources. In other cases it may require extensive training and technical assistance before being able to convince people that the change is valid and necessary. Some technical assistance may also be necessary to implement some changes.

Organization

As the Economic Liberalization Project (ELP) is heavily involved with a policy dialogue process, the economic analysis goes considerably further than is normal in most project analyses (thus calling this section Economic Considerations of the Project). The analysis provides traditional internal rates of return, but then presents more detail on the assumptions underlying the project and the possibility of liberalization in south Asia and, as well as a variety of economic relationships with India.

This "consideration" section is divided into five parts. The first presents a traditional cost effectiveness and internal rate of return analysis. The second presents a risk analysis, "the down side risk of failure". The third looks at whether liberalization is possible in Nepal so long as India remains anti-liberal and the impact on Nepal of a liberalized India. This is followed by an analysis of possible economic relationships between Nepal and India. The last part of this analysis compares, briefly, the approach of the project with that of the World Bank in its structural adjustment program.

The analyses in this annex are not fully fleshed out. These topics will be analyzed in greater detail during the course of the project. Thus what appears here are some of the considerations that have already been made and were used in conceptualizing the project. Each element in this analysis has been shared with other major donors to assure that our analyses of the problems agree with theirs and our approaches to solving the problems are compatible or complementary.

I. Estimating Costs and Benefits

While it is not difficult to estimate the costs of any individual activity, the benefits are less easily calculated. The problem is not that the outcomes are not quantifiable, but attribution of any one activity to a national output will be

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difficult. This project operates in conjunction with other donors activities, each input is necessary and contributes, but it is unlikely that any one input is sufficient to accomplish the policy change on its own. The Economic Analysis roughly follows the order of the project components section of the Project Paper, focusing on the costs and benefits involved in each activity.

I.A. Private Sector Strengthening

I.A.1. Business Organization Development

ELP will work with business organizations to improve their abilities to serve their members. This will include conducting short training courses, providing information on registration, foreign exchange allocation, marketing, potential joint ventures and developing linkages to importers in other countries. The project will monitor these activities to better understand which are cost effective for Chambers or trade associations, and which are not worth the costs involved.

These institutions need to be strengthened so there is a voice able to effectively present business case to government. Anti-business policies are adopted because of a lack of input from the private sector and because many businesspeople used by government for input have developed a close, comfortable, don't-rock-the-boat, attitude. The project will be working mainly with district and regional chambers as well as trade associations. The approach of the project will spread the benefits broadly and ensure a representative sample of business voices are heard. However, because of the importance of the Federation of Nepalese Chambers of Commerce and Industry (FNCCI), this federation will be represented on the private sector steering committee and their counsel will be very important.

There are a number of ways in which the services to members could be delivered. The project looked at each and the way being proposed by the project is not only likely to be the most successful it is also the most cost-effective. The services could be provided by strengthening the FNCCI, and allow it to provide services to member chambers. While the FNCCI is the apex chamber organization, it also directly helps many larger enterprises. These have the resources to secure the assistance they need in alternative ways. The mid-sized firms tend to belong to district Chambers and need the services proposed by the project paper. By emphasizing work with trade associations we have a way of delivering services to a large number of similarly situated firms. It is not cost effective to deliver services to each individually, but by providing to a group the cost per enterprise will fall and there is likely to be examples of relatively progressive enterprises helping the less progressive.

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This advantage can also be seen in the area of foreign trade promotion. Those firms that have been successful in exporting can help those firms trying to learn. This can be in the form of "consulting" services, or gratis. The services of a consulting firm are usually provided to individual enterprises only. However, few individual enterprises in Nepal could afford the minimum fees, nor are they large enough to cost-effectively use the consulting services. A group of enterprises, working together through their trade association or district chamber, can establish the critical mass that can be helped without major costs to any one enterprise.

The support to district chambers and associations will develop slowly. The project will not begin assisting many at once but start with only a few. As we develop the expertise then the project can expand. Thus initial work will be in the Kathmandu Valley, but as soon as possible the Project will spread to include work in the industrial areas of the Terai. The Project will emphasize working with those organizations most interested in helping themselves. Thus, they must be able to commit resources and personnel as well as having an action plan explaining what they perceive as necessary, why, and how the programs can be implemented.

The request for assistance to develop labor organizations has come from labor, management and government. There is some help that the ILO can provide, but their program in Nepal is limited and in need of additional help. USAID has collaborated with the ILO on a labor-management workshop that was exceedingly successful in bringing labor and management together in a non-confrontational, non-argumentative setting to begin the process of understanding the needs of each other. Both sides, and government officials, were pleased with the results remarking that the workshop did more to calm the waters than any other activity undertaken up to that point. The Project anticipates building on the successful relationship that has been developed with the ILO.

I.A.2. <u>Training</u>

Another major aspect of the project is training of businesspeople. Determination of the returns to education have been done for other countries, but no systematic analysis has been done in Nepal. Many feel that training has not been sufficiently focused to allow attribution, that is, much of the training of government employees has been too general to ascribe changes in policy to improved productivity, to the training. A September 1990 audit of USAID/Nepal's Participant Training Program noted that USAID/Nepal did not ensure that the Government of Nepal assigned returned participants to work where they effectively used their training. It recommended a follow-up system to monitor returned participants be implemented.

The Liberalization Project needs to establish a system to monitor how each of the participants used training. In-country business skill training will not be provided free. By charging for training, the Project is likely to reduce the chances of people taking courses for reasons unrelated to training objectives. Training outside Nepal will be directly related to current work activities. For example, training government employees in methods of valuing public enterprises for privatization, improvements in tax administration, and restructuring capital markets will relate to existing work. Private sector training is being considered in the areas of marketing, management, and financial controls. These also impact on current private sector operations.

To improve cost-effectiveness the project will endeavor to do as much training in-country as possible. Mission is currently spending approximately $7,900 per person going to the US for three weeks of training, and $4,200 for a comparable course in Bangkok (AIT). It would be cheaper to bring two teachers (@$290/day plus 50% overhead) to Kathmandu for three weeks rather than send four Nepalis to the US or seven to Bangkok. The actual determination of the most cost effective solution to specific training requirements will be based on exact comparison of the alternatives. Because most anticipated training needs are fairly basic and a number of people will need similar training, it is expected that much of the projects training will be in-country or in the region. U.S. training will be done when there are specific reasons that cannot be achieved through in-country or regional training, or when very few people need the training. As an example, if the critical element to the training is meeting potential marketing people in the U.S., then in-country training activities are unlikely to achieve the objectives of the training.

Another aspect to project-funded training is the proposed use of the IESC. It will work with individual firms, or groups of firms to improve a production process, management, financial discipline, or marketing. Each participant firm must contribute to the program, thus ensuring that they view the activity as valid. However, the end of activity report of each volunteer will provide information that can be used to assess whether these activities are worth the total cost of resources expended.

I.B. Competitive Market Development

I.B.1. Registration, Licensing and Taxation Simplification

All aspects of the project are designed to improve production and services. The activities to make the process of registration easier and faster and to make taxation more transparent and less subject to capricious actions ought to lead to registering more firms and expanded tax revenues.

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The Asian Development Bank estimated that 30% of the economy is in the informal sector. Commercial bankers in Kathmandu estimate that 40% of the non-family/relative provided credit flows through the informal sector. The key element to informal activities is their avoidance of the government bureaucracy. They do not pay taxes or abide by government regulations. Were only 5% of the informal sector to become formal through simplification and codification, and therefore pay taxes at current average rates, then the government would take in an extra Rs.25 million ($2,500,000) per year. This would make the estimated project cost for codification and simplification (under $1 million), incredibly cost effective.

We already have case studies where the implementation of the regulations led to firms not expanding, not employing additional people, or not generating foreign exchange. The project proposes to continue to provide alternate regulations to Government, to assist it in understanding that its current policies have a cost. Positive policy changes may make economic sense, but there is a need to convince people. You cannot buy these changes, nor can they be forced. But through analysis and discussion, people's ideas and attitudes can be changed.

I.B.2. Financial Services

In Nepal there are two large commercial banks, one of which is 100% state owned and the other 49% state owned, but which operates similarly to the state bank. The banks have been forced to make many loans to politically favored people, or to state enterprises that the banks knew would never be able to repay. They were forced by government to open branches throughout the country, even when the volume of business did not justify the expense of an office. Collusion between the banks has led to a lack of competition. They do not have to fight for the customer's rupees and have provided poor service and low interest rates on savings. The lack of competition has not encouraged them to search for more cost effective ways of delivering banking services.

The problems of commercial banking led to a near "bankrupt" situation for the two large commercial banks. A joint UNDP-World Bank team analyzed the problem and made recommendations, most of which government has implemented. While the UNDP is going to provide long-term technical assistance, there is a need for short-term training to improve the capability of bank staff. The courses will be made available to all commercial bankers, including the new private sector commercial bank.

This lack of service orientation, or seeking to meet the needs of customers provided fertile ground for the three joint venture banks. They were able to cream off the top clients who wanted a little service, or some assistance in international trade transactions. By taking the best customers they were able to make

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large profits quickly and reduce the profits of the two commercial banks. Just as the larger customers had improvements in their services and ability to export because of improved competition, so this project will endeavor to have increased competition improve the quality of services for more people. This includes thrift societies (credit unions), leasing companies, and finance companies. These approaches to banking may be able to provide banking services cheaper than the current approaches.

The large expansions in informal savings clubs demonstrates that the demand for such services exists. A USAID-funded workshop indicated that existing clubs cannot provide sufficient capital for a long enough period to generate desired investment. The clubs have too short a focus and operate more as ways of saving than of investing.

The commercial and joint venture banks are not mobilizing and utilizing the capital that is available. There are large amounts of savings taking place which are not being channeled to users. The project will help the Rastra Bank look at alternative credit instruments and delivery mechanisms. Even with the grossest estimates currently available it appears that mobilizing even a quarter of this savings would bring enormous benefits to the economy.

The lack of access to capital and the lack of outlets for savings, combined with the other problems the project proposes to address, like registration and licensing difficulties, has contributed to the distortion of the economy. It has forced businesses to emphasize quick returns; it has distorted investment into jewelry and housing.

Another large benefit to improved banking services is the assistance than can be provided to both importers and exporters. Exporters were the natural market for the joint venture banks, increased competition will force them to provide more services, and provide them cheaper. This reduction in costs, and improved client orientation will make it easier for others to export and thus reduce Nepal's horrendous balance of trade deficit.

The advantages for importers are less often understood. One of the reasons Nepal purchases so much from India is that it is easier. To purchase from third countries requires enormous paperwork to secure foreign exchange, as well as letters of credit and use of international financial instruments. The lack of knowledge about these instruments, and the lack of competition in banking, has made it easier to continue on a cash basis with Indian suppliers. This is in spite of knowledge that these are not the lowest cost suppliers. Because of the higher "other" costs involved, the Indian suppliers have become the lowest. By reducing some of these other costs, Nepal can lower prices within the country and provide incentives to domestic producers (high

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prices for intermediate goods discourages production).

However, the change will have have some short term costs. The increased competition will result in lower profits for those banking institutions unable to change; those willing to change will probably find they need to become more efficient and thus layoffs of personnel are likely. Banking services by more than one bank in remote locations will no longer be possible unless there is an explicit government subsidy. Hiding the cost of banking services through national profit and loss statements disguises the problem of serving remote villages. The existing systems have benefitted some people considerably. Recent studies have shown that bank officials have profited by controlling access to capital through under-the-table payments. Competition will lessen this. Politically influential people have benefitted through preferential access to capital and frequently knowing that the bank will not attempt to collect on the loan. Politicians have benefitted through their ability to reward their friends and harm their enemies through their ability to influence bank behavior.

I.B.3. Capital Market Development and Privatization

The existence of an environment where the capital market can assist businesspeople raise capital, where capital market regulators and operators are separate, benefits the capital market, the businesses and enables government to privatize through the sale of equity. Privatization without a functioning capital market limits the marketability of firms to be privatized. It would force government to sell to one person, or a small group of companies. In Nepal, concerns about equity and concentration of economic power, will require that initial privatizations be broad-based. While there are forms of privatization that do not need a capital market, increasing the options, increases the price the government is likely to receive. Valuing public enterprises is difficult since many have a negative net worth because of high debts, and accumulated losses. The government is likely to try to sell for no less than the cost of the equity they, and donors have put into the firm. These range enormously, but a rough average done by the World Bank, is that the value of the assets (excluding debt) is just over $1 million per enterprise. A fully functioning capital market would allow a higher price to be realized, and would allow, new and existing companies to raise capital cheaper. Strictly speaking privatization is a transfer of resources from government to the private sector and not an increase in value. However, the increase in value of the company and the increase in production are expansions in net economic welfare.

Privatization can be enhanced by strengthen financial markets. Privatization needs a healthy debt and equity market, requires the development of new financial instruments and institutions. Only the Securities Exchange Centre has operated as an underwriter. The National Industrial Development Corporation (NIDC) is considering trying to develop this function. Strengthening financial markets and privatization are symbiotic. Although either could be liberalized without the other, together not only are the liberalized programs more likely to succeed, but a whole range of new activities becomes possible.

The focus of the thoughts of many decision makers on privatization concerns the very high costs. These are very visible and cannot be denied. The state enterprises in Nepal, and state enterprises in almost any other country are horrendously overstaffed. They have become dumping grounds for the friends, relatives and fellow villagers of ministers and other politically influential people. Privatization, emphasis on economic efficiency, will result in a reduction in employment. This will hurt. However, using the econometric forecasting model of National Planning, we can compare the likely results of the increase in efficiency and the decrease in employment. Not including potential spread effects (improved efficiency of formerly state enterprises will help other industries), the losses in employment will be more than made up within three years. That three year cost will be significant. As politicians face an election they are likely to place a much higher discount rate on future benefits than economists looking at development over a long time horizon.

There are costs associated with taking public sector monopolies and converting them into private sector monopolies. All monopolies have high economic costs and usually have serious problem is in achieving economic efficiency. Monopolies after lack incentives to develop new products, meet consumer demands, seek new export markets, or improve economic efficiency. Because of their being the sole source of the product they can usually have high profits without being economically efficient. Thus they will appear to be productive and valuable. But the economy is paying a high price for their lack of competition. This was especially true when Janakpur Cigarette had the local monopoly. Political influence was able to open that industry and allow Surya Tobacco to compete with Janakpur. The competition had forced Janakpur Cigarette to become more efficient and responsive, although it has not been able to be as nimble and quick to respond as Surya. In this case expanding local demand and meeting the needs of the people has a social cost.

When possible enterprises should be divided to improve the chances for competition. It is the increase in competition that will drive the lowering of prices, improvements in efficiency and seeking of new products and markets. Government must encourage the development of competitive markets and remove the special subsidies, both hidden and visible, that preclude the entrance of private enterprises into the field.

The short term benefits of establishing state enterprises have exceptionally high long term costs: government has to engage in subsidizing these enterprises forever. The subsidies can be directly from the Treasury, or indirectly through the banking system, or even more indirectly, because the inefficiency leads to higher than justified prices the subsidy is paid by consumers.

The project projects spending around $250,000 per year on privatization and financial market development. If this results in one half of one company being privatized per year and the increased value of its production were only 2.5%, then over a twenty year life the real rate of return would be 9%. Alternatively, were no firms privatized, but were half of one firm, already privately owned, able to raise capital that would not have been possible otherwise, and thereby, increase production by 2.5%, then the IRR would also be 9%.

II. Risk Analysis

II.A. Institutions

In seminal work on the nature of institutions and economic reform Oliver Williamson noted the failure of economists to realize that policy reforms, no matter how well conceived and how much support there is in government, must be implemented by people. If the institutions charged with implementing the policy do not support it, then the change will fail.

It has been a traditional, if unofficial, perk of office in Nepal that an official can use his office to improve his income. Salaries for senior officials are so low that it is not surprising that they seek some way to improve their standard of living. Liberalization implies that the decision making process will be made simpler, with fewer signatures, fewer licenses, fewer controls and thus fewer times that under-the-table payments are necessary.

The project also seeks to reduce a major perk of senior officials: finding jobs for relatives and friends in the state enterprises. The economic argument that privatization is good for the macro-economy, does not hide the fact that it will have very negative effects on a number of people, many of whom are in influential positions. They are less convinced by the macro-economic arguments, then by the micro-economic ones relating to their living standards.

The control officials have over state enterprises has given them materials that would otherwise be short, job placement abilities, travel resources and power. Losing these for the good of the economy might not be sufficient incentive to many government employees.

II.B. Attitude Changes

The project has been developed keeping in mind the problems of knowing where change is possible. It emphasizes a philosophy of moving toward an open market, private sector led form of development. Within that philosophy there are many areas where the project can operate. If it finds that officials in one Ministry will not permit movement, then that portion of the project can be delayed. There is no reason to spend money influencing policy if the officials involved are not interested. The possibility of convincing a Minister or the Prime Minister of a change and having him force the issue will be addressed when appropriate. It would not have been possible during the PID state of the project to forecast the massive changes in the Nepali and Indian economic structure. It was not possible six weeks ago to forecast India's acceptance of the idea of economic liberalization. It is not possible now to forecast whether the Indian bureaucracy will thwart government policy.

Many senior Nepali government officials are now talking of the need to join the modern world and liberalize Nepal. This talk did not exist before the sitting of the new Parliament or the changes in India. They are saying things they would not have said just two months ago. The changes are too recent to be confident they are permanent. However, it does indicate that the prospects for the success of the Economic Liberalization Project are much greater than before.

Statist attitudes are deeply held, and will take long to change. Many do not believe the market price system can work in Nepal, or that there is a private sector. Others are convinced that everything Nepal imports from third countries is smuggled into India and thus strict controls are necessary. Analysis may convince some, experience may convince others, but it would be foolhardy to expect quick success, or success without an enormous struggle.

Many civil servants approach development problems from the standpoint that government must intervene, government must do something. They do not see that frequently the best thing to do is just make it easier for a business to operate and not provide additional financial incentives. Similarly, they are convinced that businesspeople can control the price of commodities. Recent raids on godowns were done on this basis. They failed to control prices because of a competitive market and higher prices in India. Even the large private businesspeople learned that they could not control prices: they could not guarantee to hold the line when higher prices in India led many farmers and merchants to export their produce rather than selling locally.

II.C. Stated Policies of the New Government

The Nepali Congress came to power with a populist platform that emphasized providing relief to the poor through lower prices, special benefits for people in remote areas, and waiving of earthquake loans of less than Rs 5,000. They promised increased facilities to government civil servants, a reduction in tax evasion and an attempt to bring additional people into the tax net. They promised to implement land reform to end the tenant farmer system and reduce the permissible land ceilings. While there was no mention of privatization, more recent statements by Congress officials indicate a greater understanding of the need to privatize. Their original position was to attempt to strengthen and improve the efficiency of state enterprises. The Party Manifesto cannot be construed as a pro-liberalization, or pro-market, pro-private sector document. Efforts to force merchants to reduce prices raise some concern about the lack of understanding of the market place and a continuing sentiment that prices can be controlled.

Still there is reason to be optimistic based on recent statements by senior government and party officials that do demonstrate an understanding of the economic problems facing Nepal. It is probably best at this time to conclude that policy will be fluid, there is no consistent philosophy or direction, but there is an openness to consider approaches that work.

The Budget of the new government emphasized an enhanced role for the private sector, privatization of three state enterprises and five farms, efforts to reform the tax system and make it understandable, and simplify business registration and licensing. The Budget Speech also cleared the way for the establishment of new financial institutions, including a commercial bank wholly owned by Nepali businesspeople. Firms have been identified for privatization, and efforts are proceeding, albeit slowly. For the first time government appointed a private businessman as Chairman of the state-run airline.

Government was able to demonstrate that it learned from the mistakes of the previous government and that it will be much more financially disciplined than earlier governments. Thus, end of the fiscal year spending was much more constrained than earlier, government refused to give into demands of government employees for improved benefits and salaries: This government has not been willing to provide subsidies to continue state enterprises in operation. These efforts of the previous government to "buy labor peace" led to excessive demands and excessive domestic borrowing.

II.D. <u>Partial Benefits</u>

The earlier sections of the economic analysis demonstrated that there are sufficient benefits to justify each of the current components of the project. But this was done with review of "generic" activities. The project will engage in

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pushing specific changes, each to be analyzed before it is begun.

The project rejected the approach of trying to emphasize just one activity and placing all the project's resources into pushing for one particular change (which could have been privatization, financial market deepening or deregulating the economy). Had this approach been taken and that element not be implementable, then the overall economic validity of the project would have been called into question. That is, were there no benefits from the element chosen then there would not have been any benefits for the entire project. However, with the approach taken if there are no benefits possible because of lack of interest of the government in one activity, then the project can switch resources to those areas where there is interest. The project can maintain overall benefits by switching between components depending on what is possible, but still maintaining the basic integrity of the project.

It is not beyond the realm of possibility that government policy will reject further liberalization. If this happens then the project must make a decision as to what ought to be done. At this point it appears best to emphasize preparing the stage for a future liberalization. In this case the project would emphasize training, support to business groups and work to develop a constituency in favor of liberalization. This could be done for less than $5 million and thus some of the resources of the project might be deobligated.

However, given recent changes in India, positive pronouncements by senior government officials in Nepal, and the economic necessity of liberalization measures in Nepal, it does not appear to be a very likely prospect that no liberalization will be acceptable to government.

III. Is Liberalization Possible?

The first question that an analysis of any project must make is whether it is possible to achieve the purposes of the project. In some projects it may be necessary to first analyze how concentration of land ownership affects the interest of farmers in improving their income; in a family planning project this could be the socio-cultural barriers to family planning. In economic liberalization there are similar initial starting points for the analysis.

The Nepali economy does not exist in a vacuum. It must interact daily with its much larger neighbor, India. That Nepalis frequently feel that being India-locked is a more serious problem than being land-locked, provides an indication of the perceived magnitude of the problem. There is ample evidence that India will permit only a limited degree of autonomy to Nepal in pursuing an independent economic policy. This limitation is most easily seen

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in the agreement that Nepal's tariff rates must be broadly supportive of India's, that is, they ought not provide too large a loophole that would undermine India's highly protectionist policies. Nepal's inadvertent error of having six import tariffs for Tibetan items lower than tariffs for comparable Indian items, was one of the contributing factors in the trade and transit impasse.

There are four different scenarios that this section will address: (a) the current situation of Nepal having slightly more liberal policies than India, (b) Nepal liberalizes further, but India does not; (c) India liberalizes but Nepal does not; and (d) both economies liberalize. Recent events in India, if they continue, suggest that only scenarios (c) and (d) are valid. The others are presented because they were central to our decision to proceed with the project, and because it is still possible that Indian officials will decide they cannot proceed with liberalization.

III.A. The Current Situation

In general Nepal has lower external tariffs than India, has fewer pernicious rules and regulations, licensing is easier, it is far easier to secure foreign exchange and the government does not dominate the modern sector as much as in India. Nepali businesspeople have seen that money could be made easily by taking advantage of India's excessive regulation and controls. One could import an item from third countries and the same day sell it to Indians making a 50% profit. The return was so great that it made little sense to people to engage in the struggle to industrialize where the return might only be 15-20% per annum. The surprising result is not that Nepalis turned to trading and smuggling, but that any industry developed.

India's arcane and incomprehensibly complex price controls have led many Nepalis to use loopholes whereby they could purchase in India for export (at low export prices) and then sell those same items in India. By guile and quickness they were able to outwit the Indian license raj. Needless to say the Indian government has protested frequently about this, and insisted that the Nepali government take action. However, because the profits are so great, and the effort it takes is so little, business was able to find a loophole in every action the government took. It has been alleged, and there is sufficient proof to believe it, that there was some high level chicanery whereby smugglers shared their gains with senior Panchayat government officials.

The frequently forgotten third treaty during the Trade and Transit dispute dealt with smuggling. It promised increased vigilance, but little has taken place. This remains one of the major industries in Nepal, especially when the Nepali assembly industries are included. The assembly industries take imported components and assemble the product in Nepal. A substantial rationale for the industry being in Nepal is the large profits from illegal exports to India. This includes not only the assembly of electric and electronic equipment, but the "manufacture" of polyester cloth and brewing of international beers.

The result of current policies is an emphasis on smuggling by a substantial portion of the private sector. The Finance Minister in the previous Interim Government castigated the smugglers and vowed to remove their incentives. However, there was not much he could do since the problem is in India and the profits are great. His approach also illustrated one of the problems in Nepal: there is an ability to discover the dilemas, but the solution only makes the situation worse. In his case he tried to end smuggling by regulation and police work; he did not remove the rationale for smuggling. That could be done through changes in policy in India, or through giving positive incentives in Nepal to produce for exports to third countries. It is significant that the two major manufacturing exports, carpets and garments, developed without any government assistance or support.

The former Finance Minister was correct in diagnosing that one of the major results of the current policy is an unbalanced development that is not good for the country. Because profits are easily obtained through smuggling, there is little incentive to engage in production. Available investment capital is used to finance imports, or conspicuous consumption like housing and jewelry; it has not gone into productive use. Some of what appears to be productive use is not actually productive. For example, much of the synthetic textile industry uses imported polyester beads to make yarn and cloth for sale along the border. It is estimated that at least 60% of this is sold in India illegally. Recently two new beer brewing companies began operations in Nepal. The market in Nepal is not large enough to support four major producers: but the market in India can support the imported beer brands easily.

Nepal is one of the least liberalized countries in Asia, but it is more liberal than India. In this strange situation there is an enormous opportunity. Nepal could offer Indian firms better access to foreign technology, capital goods and raw materials; it could offer them greater ability to retain their hard currency export earnings. In this way Nepal ought to be able to attract Indian firms to move some of their operations to Nepal and set up shop. Only in the last year has there been any effort to try and sell this aspect of Nepal to Indian entrepreneurs. The initial results were encouraging, seventeen agreements were signed. However, only a few are actually beginning operation. The others wanted to wait and see what happened with the Nepali elections.

While this use-India strategy offers many opportunities, it suffers from a major defect that reduces its usefulness. Many Nepalis already sense an enormous dependency on India and that India would like to control Nepal even more. Such a policy is perceived as leading to even greater dependency on India and Indians. While I disagree with this perception, it is strongly felt.

III.B. Only Nepal Liberalizes

Can Nepal successfully liberalize if India does not?

The short, glib answer is yes, but will not help achieve the purpose of industrializing and broadening the economy. So long as the incentives to smuggling are so great and the returns to manufacturing investments relatively low, the benefits of liberalization will be reduced. Liberalization and the opening of the economy require permitting more Indian investment in Nepal. Nepal is unlikely to attract much third-country investment, thus, if it precludes Indian investment, there is likely to be very little investment of any type.

Liberalization of foreign exchange rules, or tariffs will further exaggerate the difference in prices between goods in Nepal and India and therefore could lead to even more smuggling. Making it easier for firms to register and do business will lead to expansion of industrial activities, but the focus will remain on producing items that can be smuggled to India. Thus, there is a posibility that liberalization may increase opportunities for corruption.

Privatization and improvements in financial markets will all be beneficial, but because of the framework within which they will work, the benefits will be lessened. Opening the economy to international competition and redirecting government policy away from import substitution and toward export promotion will have limited success since the returns are less than from smuggling. However, businesspeople who are not interested in smuggling will be able to take advantage of the changed environment to produce more and improve profits.

In short, it will be very difficult for Nepal to liberalize to any meaningful degree if India does not. However, there are some limited steps that Nepal could take, and that the Project could support, even if India does not liberalize its economy.

Carpets as an Example

Carpets developed without government assistance, incentives or direction. There was no government marketing agent, no government office to advise on designs, exporting, or to help on importing the raw materials. This industry is an exceedingly easy one to enter, the investment is low, the skills are easy to master, and the demand for the output is so high that one can easily engage in just a part of the entire carpet exporting industry. A firm or person can simply import raw materials, take the raw wool and dye it, or make it into yarn, or weave, or wash or export, or any combination of these.

Many have argued that this industry is threatened by Indian lower cost competition and will soon become defunct. This is unlikely because of innate advantages in Nepal. Nepal has no problems purchasing raw wool from New Zealand and Tibet. India wants to protect the domestic wool industry and thus insists on greater use of local wool. Nepal can use dyes from any country and thus meet the exact color requirements of international markets; India insists on using local dyes. The Nepali entrepreneurs are much faster in reacting to changing market demand. The carpets being made this year are different from the ones last year, and the enormous competition is leading many to search for new niches and approaches. India protects and shields its producers from the international market, leading to slower response times and less willingness to meet the exacting demands of international buyers. The Nepali entrepreneurs realized a decade ago that they could continue to produce traditional designs and export to a limited market, or the could produce what the market wanted and export to a greater market. There is no longer anything Nepali about most of the designs in exported carpets. A few of the traditional designs are still exported as specialty items and more of these are produced for purchase by tourists, but they are a very minor portion of the market.

Interestingly because the sector is so competitive, government has simplified the rules and regulations effecting the industry. Registration of these firms has been easier than for other types of firms and there are fewer examples of under-the-table payments. The paperwork needed for exports is less and the problems with customs much less, than for other industries. Protection of industries, whether because they were once "infants" or because of political influence, results in a layer of bureaucracy that stifles development. Protection may lead to greater profits than would otherwise be the case and therefore more opportunities for demanding a share of those profits.

A roughly similar experience exists for readymade garments. It too is characterized by ease of entrance and competition. There are many firms in the industry, none of them dominate and therefore none can try to monopolize the industry. When demand drops, enterprises go out of business; when demand increases, new firms are established. Government does not forbid firms from closing, and makes it easier for new firms to become established. There is little corruption in licensing, in importing raw materials, or arranging exports.

These examples demonstrate that within a liberalized environment Nepal can thrive. It can be responsive to the market and export. These examples demonstrate the lie within the statement that there are no Nepali entrepreneurs: they exist, but they have often been thwarted by government's protection.

III.C. Only India Liberalizes

Currently India is having enormous balance of payments problems. It lacks foreign exchange to pay for its restricted level of imports and faces budgetary difficulties because of a bloated bureaucracy and grossly inefficient state enterprises. India has been forced to further restrict imports, restrain some subsidies, and demand state enterprises rely more on their own resources. India has had to look to multilateral lending institutions and donors for foreign exchange. While there are many rumors, probably few correct, about the nature of discussions with lenders, it is likely that the banks and donors will ask for the relatively standard package of adjustments in return for the needed foreign exchange.

The standard package basically would require India to follow many of the precepts of the Economic Liberalization Project: opening up to competition, export orientation, making it easier to do business, privatization, reduced government meddling in the economy, financial market liberalization, and a more realistic external exchange rate of the rupee.

This section of the analysis basically looks at this what-if scenario and its impact on Nepal.

A liberalized India would eliminate the profitabilty of a Nepali smuggling industry. It exists because of India's rules, regulations and protectionism. The loss of this industry will reduce the income of many Nepalis and undoubtedly hurt the Kathmandu construction and jewelry businesses. This change would also harm that part of the tourism industry that caters to Indian tourists interested in coming to Nepal to purchase third country goods. Those Indian tourists interested in gambling might still be attracted to Nepal as liberalizing gambling is not part of the standard World Bank/IMF liberalization package.

This liberalization would hurt the potential appeal for Indian businesses in Nepal focusing on export to third countries. The benefits of remaining at home would outweigh the benefits of operating in Nepal. Similarly, the synthetic fabric and beer industries would contract or disappear.

Assuming that India's liberalization extends to permitting more agricultural imports, then Nepali agriculture ought to do

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better because higher prices (reduction in subsidies) in India would permit more Nepali exports, and the elimination of Indian import subsidies would remove some of the cost advantage enjoyed by Indian producers. An improved availability of Indian agricultural raw materials, and the likely reduction in prices (agricultural inputs is a protected industry with prices in excess of world market prices) will benefit Nepali farmers.

A liberalized Indian economy would likely lead to serious short-term dislocations in the economy as different elements adjust faster than others. Those elements that are most protected now would have the greatest adjustments and presumably some would go out of business as more efficient foreign producers provide better or less expensive goods. Nepal could exploit some of these dislocations as Nepal has been more liberal and thus more internationally competitive. Most of these benefits would be transitory as India's liberalization begins to affect more and more elements.

In general, a more liberal India would offer greater export opportunities to the more efficient Nepali producers; it would also be able to provide better and less expensive goods to Nepal. A more liberal India would also be able to provide more jobs to Nepalis.

III.D. Both Countries Liberalize

This scenario has elements of scenarios (b) and (c), but is more interesting in that neither economy would be able to take advantage of the anti-liberal elements in the other economy. The most interesting element of this scenario is that it would force Nepal to consider what it can "offer" the world; what can Nepal produce relatively cheaper than other countries, not what can it take advantage of because of the the failed policies in India.

Nepal has certain comparative advantages within certain sectors (or the competitive advantage using a faddish approach). There is little doubt that one of the industries that still would exist in Nepal is the tourism industry. It is rooted in real conditions that cannot be duplicated elsewhere. It is likely that Nepal could take advantage of the industry by developing forward or backward linkages. The carpet industry is likely to be able to continue in a more liberalized environment as it has been operating hasn't liberalized. Thus the entrepreneurs have developed the appropriate skills that could benefit from operating in a more liberal country. The readymade garment industry is not likely to be affected since it exists in Nepal because of the quota policies in the U.S. An activity that could do very well in a joint-liberal environment is agriculture. Because of the large number of micro-climates in Nepal, it can produce items for the larger Indian market at times Indian producers could not.

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Other manufacturing industries could either be based on efficient agricultural production (agriculture processing industries) or on the skills of entrepreneurs. Those industries that exist because of governmental protection are likely to suffer.

IV. Economic Relationship of Nepal and India

During the Trade and Transit Impasse with India, Nepal was forced to conduct trade on the basis of most favored nation (MFN) status. The arrangements were not negotiated, but done by default. The preferential arrangements ended and there was nothing to put in its place. Nepal unilaterally provided some special preferences for goods traditionally imported from India in an effort to ease shortages and lower inflation. This period cannot be viewed as Nepal's experiment with MFN, as no efforts were made to reorient industries, there was no phasing, nor was it viewed as permanent, just as something necessary until a new agreement could be developed. Industries made emergency adjustments but did not reorient their programs. The temporary MFN was not accompanied by industrial restructuring or liberalization of the economy.

At this time, considerable thought is being given to the range of possible economic relations with India. These range from moving toward a true MFN trading system, some form of more stable economic union with India, or a return to the previous preferential arrangements.

IV.A. Most Favored Nation (MFN)

Under a normal MFN, two countries do not bias trade toward each other but allow trade to take place based on who provides the desired goods cheapest. There is no special preference, or bias. This contrasts with the current system where both countries provide what they perceive to be major advantages to the other country. Nepal provides all Indian goods with lower tariffs than non-Indian goods, does not require special work permits for Indians, there are no capital repatriation controls, and Nepal allows Indians to use their rupees in Nepal without exchange controls. India does allow Nepalis to work in India, travel easily, purchase land and, on paper at least, allow those goods with 65% Indo-Nepali material content preferential access to India. The last benefit was agreed upon at the last set of negotiations, but thus far no Nepali company has received this new dispensation. Each side places the blame for delays on the other side's bureaucracy.

The current economic relationship leads to Nepal purchasing from the non-least cost supplier, India. This is because preferential treatment of purchases from India reduces their delivered costs to the consumer in Nepal (the costs of production are frequently higher in India and the costs delivered

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to the border are higher). The treatment of Indian vs. third country goods by the Nepali government often skews trade. For many electrical goods the tariff from India is 70%, while the tariff from third countries is 120%. Actually, the Nepali government goes further and frequently insists that Nepali firms "buy Indian" even if prices are cheaper elsewhere. This is done in the interest of using appropriate technology and uniformity. It is assumed that purchases from India use the appropriate technology while purchases from elsewhere on the sub-continent or South East Asia do not. This policy often shackles Nepal with outmoded and expensive techniques goods and related technology.

IV.B. Full MFN with Liberalization

This extreme solution would have trade and economic relations take place on the basis of a full MFN with both sides using hard currencies for all transactions. Full MFN simply implies that all countries are treated alike with respect to trade, there would be no special relationships. Nepal would look to heightened worldwide efficiency and could possibly exploit its ability to import from third countries cheaply, process and export to India. Some problems relate to the open border which cannot be sealed. There is considerable room for smuggling and thus problems with India. If there are high MFN tariffs then smuggling will take place from India, if there are low tariffs then smuggling to India. If the tariffs are approximately the same then there is little reason for smuggling in either direction.

There is also a problem with the exchange rate. At present Nepal has a considerably more liberal approach to foreign exchange. This is partly because of the mistaken belief that the country has extensive reserves. Nepal is liberal because of a misunderstanding about the source of the large foreign reserves. The gross foreign assets are equal to 7 months of imports, but the country runs a chronic balance of trade and balance of payments deficit. The reserves are present because of loans from multilateral lending institutions. Nepal's increasing reserves are less than its increasing debt. Since the loans have not been used to increase hard currency export potential, a crisis is developing. It is only now becoming visible in a tight budget situation and complaints about the proportion of the current budget that must be allocated to repaying the debt are growing.

Nepal has to decide how restrictive it wants foreign exchange controls to be. The more restrictive it is the less the benefits of third world trade will be. If Indian trade must be in hard currencies then India will reduce purchases from Nepal and might not agree to future electricity purchases from Nepal. Sales of energy to India are important to Nepal's development strategy that views the development of hydro-electricity as the critical element.

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If Indian goods are imported at the same terms and with the same licensing as other countries, then there will be increased prices in Nepal. If all are "liberalized" to the lower Indian rates, then prices in Nepal will fall and people's choices will increase. Most likely some compromise will be forged that would initially find a mid-point between the two tariff rates. This would increase the costs of doing business with India while decreasing the amount of trade with India. The costs of importing from third countries would decrease and thus increase the quantity of trade.

The Nepali rupee was overvalued by 15-20% before the recent 34% cumulative devaluation. This has made Nepal a relatively low cost producer and thus has more than restored its international competitiveness. The excess devaluation reflected the need for a larger devaluation in India. Nepal went along with this even though the amounts are much greater than justified for Nepal. However, the Nepali rupee was also overvalued with respect to the Indian rupee. Thus, while Nepal did not need to devalue by 34% simply because India devalued by 37%, Nepal cannot afford to revalue to achieve the appropriate exchange rate with the rest of the world. Nepal must remain competitive with respect to India and thus be relatively undervalued.

The movement toward an undervalued currency ought to stimulate exports, especially carpets, garments and tourism. It will also restrict imports, especially from third countries, and there will be less of a pressure to reduce imports from India. In fact, because of the substitution effect there will be a replacement of some foreign imports by Indian imports.

The effect of MFN on tariff receipts depends on the level of tariffs. In general, economists have found that rates in excess of 40% are counterproductive with respect to improving collections. Lower tariffs will increase the amount imported, and especially for those items with very high rates, the elasticities are such that the lower rates will generate increased collections (that is, a 50% reduction in rates would result in an increase in quantity in excess of 50% and therefore an increase in collections).

IV.C. MFN with Partial Indian Rupee Convertibility

This would begin with the position that there are sufficient benefits to MFN, but because of the need for a close relationship with India special arrangements with India are necessary. Nepalis could pay for some imports from India in hard currency and thus not pay Indian excise taxes and benefit from Indian export incentives. Were Nepalis to pay in Indian rupees then they would not receive the Indian export incentives but would have the benefit of a 20-25% reduction in Nepali cost because of the use of the "Hawala rate" and not the official rate.

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This approach has the advantage of being less threatening to India's economic policy and thus it is less likely that India will object. If India continues on its current liberalization track, then this approach is irrelevant as the Indian rupee will be becoming a hard currency.

IV.D. Customs Union/Common Market

Should Nepal and India consider an economic union, a customs union or a free trade arrangement?

The answer basically depends on the determination of the type of liberalization scenarios followed by Nepal and India. If only one of the countries liberalizes, then the economic policies would differ too much to make harmonization of policies possible. Because of the differences in size, almost any form of economic union would result in Nepal adopting the economic policies of India. If India becomes more liberal, this would be beneficial to Nepal in the long run as a way to force liberalization on the economy.

For example, to consider a customs union with common external and no internal tariffs would mean that Nepal adopts the highly protectionist policies of India, but without the resources to engage in the massive subsidization of the economy. (Since India cannot afford these either, ultimately, there would have to be changes there as well.) There would be no reason for firms to locate in Nepal, or try to use Nepal's advantages. There would be some advantages to a customs union in that Nepali exports could go to India tax and duty free, and presumably India might be more generous in providing resources for infrastructure and economic development of Nepal than it presently does. India is one of the largest bilateral donors to Nepal. There are many requests with the Ministries of Industry and Commerce to export to India, but approval for preferential access has not been received. A customs union would remove the border customs facilities and facilitate Nepali exports to India.

So long as India's economic policies are so counter-productive to development, such a union would not be in Nepal's interest. But if both countries liberalized, then such an arrangement might make economic sense. There will, however, remain many political arguments against doing this. A customs union would reduce economic sovereignty as Nepal could not maintain an independent fiscal or monetary policy (this is not too serious since the policies do not differ much now). Nepalis fear being swamped by larger and potentially more efficient Indian firms. The fear is exaggerated since one of the reasons for the World Bank's insisting on India liberalizing is because India's firms are not efficient. More than this, businesspeople fear the loss of their comfortable, safe, protected environment in Nepal with the current close working relationship of senior government

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officials and leading businesspeople.

Because of the ease of movement by people and of goods across the open border, there is a form of "common market" between the two countries now, but not a customs union. A customs union with India would require that Nepal adopt India's tariffs and import restrictions vis a vis third countries and there would have to be harmonization of monetary and tax policy. Some Nepali industries would benefit from access to much larger markets, especially those that could produce goods cheaper than Indian firms. There would, however, be significant adjustment problems. Nepal's exports to third countries would be hurt to the extent that Nepal is forced to use more expensive and lower quality Indian inputs. A customs union would lead to greater dependence on India.

V. Structural Adjustment and the Approach of the Liberalization Project

This project takes a slightly different approach to trying to change policy than is done in many other projects. The traditional USAID project targets a sector and provides technical assistance, commodities, training and other resources to work with the line ministry, parliament, and private sector to make a change. The emphasis is on a single sector or action at one time, and tightly focused policies. This project is different in that its interests cut across all the development ministries. It shall seek to change more macro-economic oriented policies. It will not be imposing any substantive conditions on its assistance.

The World Bank's approach to structural adjustment has been to encourage change by reducing the costs involved. Many needed policy changes will cost the government money. For example, the proposed changes in taxation are likely to result in initial shortfalls in receipts for one or two years. The World Bank's approach would be to provide the resources to cover those shortfalls. USAID's in countries engaged in privatization have reduced the cost of reducing staff by funding all or part of the "golden handshake" provided to encourage workers to resign and be training for new activities.

This type of activity can be effective and ease the costs to government, but this Project does not have the resources to do so. In any case, the work we are proposing to do will be coordinated with the World Bank will support their efforts, and thus we will be able to complement their greater resources to provide additional support. The Economic Liberalization Project works to convince government and private individuals that the changes proposed are in their interests. It works with people who are willing to consider the liberalization model and it provides them with the intellectual resources (studies, technical assistance and training) to convince senior decision makers of the validity of change.

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Each approach has its merits and taken together they may be able to effect changes otherwise impossible. Traditional projects are often too tightly focused to handle macro-economic issues. Large structural adjustment projects often force a change that is not really accepted locally and is therefore often "undone" at the earliest opportunity.

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VII. ANALYSES

ANALYSIS B

Social Analysis

Evaluating Some Key Project Assumptions

One key project assumption is that policy and procedural changes intended to "open the system" and "get the incentives right" will receive a positive response, that Nepalese citizens will be sufficiently entrepreneurial to respond, quickly and in large numbers. While some administrative and political leaders express doubts about this assumption--e.g. by voicing fears of Indian domination of a more open economy--there is substantial evidence that USAID's optimistic assumption is correct. Several examples are sufficient to demonstrate and reinforce the assumption. Some cases represent straightforward responses to opportunities, and can simply be labeled "entrepreneurship". Others demonstrate persistence and creativity in the face of complex, unrealistic regulations and deserve a special label of "loophole" or "illicit" entrepreneurship. Finally, the hard labor and risks hill and mountain farmers are willing to undertake to ensure a minimal living standard for their families deserve the label "subsistence" entrepreneurship.

Examples of "straight" entrepreneurship include:

- The carpet industry: This industry, barely 30 years old, was initiated through Swiss assistance to Tibetan businessmen and women. Currently, hundreds of firms, many operated by non-Tibetan Nepalese, employ tens of thousands of workers, and carpets are Nepal's second most important foreign exchange earner.

- Tourism in Rural Nepal: Thakali bhattis (teahouse hotels) in the Kali Ghandaki Valley, and Sherpa trekking firms operating in many hill and mountain areas represent substantial, appropriate responses, (within a single generation) to highly specialized opportunities presented by Western trekkers.

- Tourism outside Nepal: The Night Bazaar, a major tourist attraction in Chiang Mai, Thailand, features a substantial section devoted to sale of Nepalese jewelry. Manangi and Thakali businesspeople export these goods into a large handicraft market that has grown up within the past 15 years.

- Foreign labor: Significant numbers of Nepalese, many from isolated rural areas, serve as legal and illegal labor migrants in the Persian Gulf, Singapore, and Japan.

Examples of "loophole" or "illicit" entrepreneurship include:

- The "soccer teams": Government regulations allow individual import of clearly-specified quantities of clothing (shirts, trousers, caps, etc.) and other personal goods (watches, cigarettes). "Loophole" entrepreneurs have discovered it is profitable to fly groups of villagers (with their bulky sweatsuits of uniform color and design, which cover several layers of new clothing, they resemble sports teams on the return journey) to Dhaka, put them up for a couple of nights in a cheap hotel and bring them back with their individual allotments of duty free goods. Savings on import duties apparently exceed costs of round trip airfare and expenses in Dhaka. A large volume of consumer goods enter the Kathmandu market in this way.

o Smuggling: Smuggling is an illicit (and entrepreneurial) response to high import/export duties and administered prices worldwide, and unsanctioned transport of goods across the Nepal-India border has existed for generations. However, the 1989 trade and transit dispute, which paralyzed legal Nepal-India trade for several months, led to the entry of thousands of new "illicit" entrepreneurs into the trade. Many items were of surprisingly high bulk and low value (e.g. agricultural commodities), suggesting that calculations of potential profits are made with great care.

Examples of "subsistence" enterpreneurship include:

o Seasonal labor migration: In addition to thousands of Nepalese who migrate as far as Saudi Arabia and Japan for a year or two at a time, hundreds of thousands of hill and mountain residents migrate for a few winter months each year to urban centers (Kathmandu, Pokhara), the Terai, and northern, western, and eastern India. Many go into low-paying, unskilled occupations as laborers, chowkidars, etc.; however, even these migrants demonstrate impressive energy, courage, and risk taking by travelling to sites many days and hundreds of kilometers from their home villages. A significant minority of this large group are able to acquire higher paying skills as drivers, carpenters, masons, etc. Others demonstrate significant entrepreneurial qualities by establishing small, temporary businesses (Thakali women who distill and sell traditional liquor in Pokhara) or finding special marketing niches (Jumla residents who sell wool products in Assam).

o Traditional infrastructure: Hill and mountain residents of Nepal have captured a high portion of the productive potential of a uniquely difficult environment through: several types of agricultural terraces; farmer-managed, gravity-fed irrigation systems; water-powered grist mills; and traditional suspension bridges. Each of these installations represents: impressive human energy inputs during construction; effective, sustained management of operation and maintenance; and significant inputs of "subsistence entrepreneurship" to mobilize the labor and materials required at the outset of construction.

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Another key project assumption is that activities outlined here will succeed in significantly altering an entrenched, highly centralized bureaucracy that has generally hindered entrepreneurial behavior and business growth. For analytical purposes, this optimistic assumption can be re-cast as a more pessimistic question. Why should we be optimistic that a system entrenched over a 30 year period can be changed to any useful degree by this modest project? Observation of the system over three years (for 18 months before arrival of multi-party democracy and 18 months after) gives cause for both pessimism and optimism.

Reasons for pessimism: Many potentially-obstructive bureaucrats and bureaucracies are still in place, ensuring that access to licenses, raw materials, utilities, operating capital, foreign exchange and other crucial business inputs remain inordinately complex and time consuming. Bureaucrats won't readily give up regulatory roles under which they gain power and (some) side payments. Even if policies and regulations change, many officials will seek ways to continue to exert control and retain their mastery of slowdown, rationing, and obfuscation, using one set of assumptions (e.g. about excessive installed capacity, limited market depth, or unavailability of raw materials) to turn down unknown and honest applicants, and different assumptions to smooth the way for the favored few. Some senior bureaucrats (and politicians) will continue to use rhetorical flourishes of particular power in the region, arguing they are protecting "the people" against rapacious middlemen, price gougers, hoarders, and those with mysterious Indian connections, while attempting to maintain centralized control.

Also, a small number of disproportionately powerful business people were able, through alliances with powerful groups, to do quite well within the skewed and protected markets of the Panchayat system. They are capable of creating considerable "noise" in the current situation, by professing "born again" commitment to competition and free markets, while working behind the scenes to retain advantages.

Another problem is lack of an appropriate political party base for articulating business views. Although clearly occupying the center of Nepal's party spectrum, Nepal Congress is still largely dominated by a Fabian Socialist mindset. Rightist parties are currently discredited by their associations with the Panchayat system, and business people associated with them are likely to be more adept in gaining behind-the-scenes advantages, than in working openly for positive change.

Causes for Optimism: In spite of the socialist/centrist mindset of many government administrators and politicians, multi-party democracy offers far more openings for a policy reform project. Business groups and associated researchers are now free to gather data, carry out analyses, organize public debate, openly

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criticize systemic weaknesses, and lobby for change. Although these activities were officially sanctioned under the Panchayat system, in reality they were severely constrained. The arrival of democracy has made a genuine difference.

In addition, the project, which pursues "micro-policy dialogue" in a wide range of sectors, will operate within the framework of macro-reform established by the World Bank and IMF. Liberalization of the Indian economy (which has been initiated, and will presumably be ongoing), will make similar changes more intellectually respectable in Nepal, and greatly strengthen the position of local advocates of reform. The long, porous border and well-established traditions of unimpeded movement between the countries, which until now has dictated centralization and price controls complementary to India's, is a physical reality that will now make price controls and over-complex import and export controls increasingly untenable.

A Balanced Judgement: Reasons for pessimism catalogued above are genuine, will frequently complicate project implementation, and will dictate that some reform efforts fall short, due to compromise. However, the Nepalese economic system has never been more receptive to reform than at present, and a number of key actors--chambers of commerce and other business associations, Kathmandu-based and provincial businessmen, NGOs, some key administrators and politicians, and a surprising number of young intellectuals connected with political parties--can be enlisted to work with the project. Many project initiatives can be expected to succeed.

A Dilemma: Achieving Both Effectiveness and Equity

If the project is to be reasonably effective, and tap the dynamism of the existing private sector, we must work closely with business-oriented ethnic groups--upper- and mid-caste Newars, Marwaris, Thakalis, Manangis, Sherpas, Tibetans, some Brahmins--in the short-term. However, if we're concerned with long-term expansion of the private sector, and with reasonable standards of equity, it's essential all potential entrepreneurs--women, middle and lower castes, Tharu and Tibeto-Burman "tribes"--have reasonable opportunities for involvement.

No clever principles or subtlety of design can fully solve this dilemma. Project implementors will find themselves working predominantly with members of traditional business groups in data collection, analysis, and lobbying work essential for project success and system reform. It would be poor tactics to work mainly with those who are inexperienced, unskilled, and poorly connected in trying to reform the system.

On the other hand, it's poor strategy to attempt to build a strong, dynamic private sector on a narrow human resource base.

Entrepreneurship is rare under any circumstances, and particularly so in South Asia where commercial activities have been conceded to a few caste groups. The base in Nepal must be broadened. Direct efforts to achieve greater long-term equity in access to business opportunities will not only benefit disadvantaged individuals in the short-term, but Nepalese development in the long-term.

Equity concerns should be addressed regularly in allocating project benefits (notably training, technical assistance, and information). The guiding principle cannot extend usefully to "full equity", but should incorporate the notion of "reasonable access". This principle can be applied most obviously in designing training programs and selecting trainees. It can also be applied in selecting businesses for TA (e.g. under the IESC program) and even in assembling mailing lists for reports and other information produced under the project.

Reasonable access in training programs can be achieved by adhering to the 33% female quota the Mission currently applies under its general training program; and by adopting an active "outreach" strategy (perhaps through a contract with a local organization), to identify potential trainees who are female, who reside outside the Valley, or who belong to groups not traditionally "business-oriented". The project should emphasize training opportunities which bypass normal academic and English language barriers--e.g., group training with translator, in-country training, training in Hindi and Urdu in India and Pakistan.

Project managers must actively monitor training selection processes. Trainee groups which are exclusively Brahmin/Newar/Marwari should be rejected and re-constituted. Persistent efforts should be made to enlist females, those from outside the Valley, and members of disadvantaged groups. Thus, through a principle of "reasonable access", the entrepreneurial base can be gradually expanded.

Similar effort should be given to ensuring "reasonable access" to TA and information.

The project will undoubtedly encounter some setbacks, due to resistance by certain groups described above, but Nepal's far more open political system will allow many project activities to achieve full or partial success.

VII. ANALYSES

ANALYSIS C

Institutional/Administrative Analysis

The Economic Liberalization Project seeks to improve the business environment of Nepal. Currently, there is distrust and misunderstanding between government and the private sector. There is a need to strengthen not only chambers and trade associations but also government ministries and agencies to carry out the needed reforms and to benefit from the resulting changes. The project's Policy Dialogue Steering Committee will consist of representatives from involved government offices and private sector associations.

Government Organizations: Previously, decision-making was highly centralized in the Palace. Government organizations functioned at the operations level, but authority for framing policies and regulations was not delegated to them. As a result decision-making was very slow and it was difficult to determine the rationale for decisions. There were two secretariats: the ministries and Palace secretariat. Most decisions were controlled by the Palace secretariat. The Palace appointed loyal functionaries to all senior government positions. Officials were more used to taking orders than formulating policies.

Inter-ministerial transfer of staff was frequent and in many instances these officials did not have the background suitable to the jobs. This made it more difficult to develop sufficient knowledge to argue effectively for changes; they could not provide leadership and government employees found career development dependent on acquiescing to Palace policy decisions, not on independent analysis.

Government ministries and corporations are over-staffed and because of lack of delegation of authority, top level officials are overburdened while lower level staff are often redundant.

Since the success of the Multi-Party Movement, the Palace secretariat has been eliminated. This has increased the decision-making of ministries. Bureaucrats have not adjusted to this change which demands responsibility and accountability. But it is expected that as officials begins making decisions, they will gain confidence and the decision-making process will become albeit slowly, more decentralized.

The major administrative problem in Nepal is the lack of coordination and linkage among ministries. The Ministry of Finance dominates all operating ministries with its control of the budget and macroeconomic policies. The National Planning Commission does not have much say in budget development or allocation, or the implementation of plans. Its formulation of periodic plan documents has not provided much guidance to government policy.

There are few officials that have been given the orders to develop alternative ways of restructuring public enterprises, developing capital market and analyzing the impact of current foreign exchange rate and trade regimes. They are interested in these issues, and acknowledge their critical importance. Knowledge of policy alternatives is inadequate little thought has been given to liberalization issues as the number of senior economists is small, reflecting the shortage of trained people with analytical skills. USAID has assisted in developing a discussion group to analyze these issues and make recommendations for action.

To coordinate and identify plans, programs and policies, a focal organization is needed as the project requires active participation of decision-makers from different ministries. There is a need to improve the analytical capability of government ministries and agencies through training and involving Nepalese expatriates in joint research works. Short and long-term technical assistance will be used for this purpose.

Private Sector: For the growth of private sector there is a need for effective participation by private business organizations and businesspeople in partnership with the government. Nepal and Lalitpur Chambers of Commerce, Tourism/Handicraft/Foreign Trade Associations, and the JayCees are fairly strong organizations, with capable leadership, active membership and a good knowledge of some issues. All chambers and associations are government registered and have legal status. They provide a forum for members to discuss issues, plans and problems. In the past, issues raised by them have not received government response. They are agreeable to the idea of cost-sharing for various improvement and training activities. With help to be provided through training and limited commodity assistance, these associations will be able to implement this project. The apex business organization in Nepal, the Federation of Nepalese Chambers of Commerce and Industry, will also be involved in advising the Project on needs of the business community.

Some efforts have already been made in increasing the participation of the private sector. The Nepal Chamber is being currently coordinating USAID's activities that had developed out of the IRIS Forum. These include simplification of government procedures regarding business registration, taxation and access to capital.