



GRADUATE SCHOOL OF DEVELOPMENT STUDIES

**The Perils of Privatisation:
Possibility, Problems and Prospects of Divestiture in Nepal**

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(Nepal)

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THEORY

The first part of the theory is the definition of the function $f(x)$ and the function $g(x)$. The function $f(x)$ is defined as the function $f(x)$ and the function $g(x)$ is defined as the function $g(x)$.

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ACRONYMS

ATF	Agricultural Tools Factory
BBF	Bhaktapur Bricks Factory
BJM	Biratnagar Jute Mills
BLSF	Bansbari Leather and Shoe Factory
BPM	Bhrikuti Paper Mills
BTI	Balauju Textile Industry
CRPS	Council of Retired Public Servants
DAG	Department of Auditor General
GDP	Gross Domestic Product
IMF	International Monetary Fund
HBTF	Harisiddhi Brick and Tile Factory
HMG/N	His Majesty's Government of Nepal
MLJ	Ministry of Law and Justice
MOC	Ministry of Commerce
MOF	Ministry of Finance
MOI	Ministry of Industry
NBBI	Nepal Bitumen and Barrel Industry
NBL	Nepal Bank Ltd.
NFDC	Nepal Film Development Company
NFI	Nepal Foundry Industry
NJTDTTC	Nepal Jute Development and Trading Company
NLO	Nepal Lube Oil
NPC	National Planning Commission
NPM	New Public Management
PC	Privatisation Committee
PEs	Public Enterprises
RHCDC	Raw Hide Collection and Development Corporation
RJM	Raghupati Jute Mills
SAP	Structural Adjustment Programme
SCOPE	Society for Constitutional and Parliamentary Exercises
SOE	State Owned Enterprises
TDC	Tobacco Development Company
UNDP	United Nations Development Programme
USAID	United State Agency for International Development
WB	World Bank

Chronology of Major Political Events and Activities of PEs in Nepal

Year	Major Political Events	Major Activities with Reference to PEs
1951	The 104 year old Rana family rule was overthrown and democratic political system was introduced. Nepal started to promote economic development.	
1954	King Mahendra started to rule after the demise of King Tribhuvan.	Government bought majority of shares, increasing its shares from 40 to 51 percent, of Nepal Bank Limited which was the first public enterprise of Nepal.
1959	The general election to the parliament was held and the Nepali Congress party formed the government.	Government established seven PEs during the First Five Year Plan (1959-1960).
1960	King Mahendra dissolved the parliament and banned political parties.	During no plan period (1961-62), government established three PEs.
1962	Partyless Panchayat political system was introduced. This political system was influenced by the socialism that believed the active role of state could help for the socio-economic development of country.	During Second Plan (1963-65), government established 11 PEs. Among them, the then Soviet Union granted aid to establish cigarette and sugar factory.
1967	Back to the Village National Campaign was introduced.	During Third Plan (1965-70), 12 PEs were established. Chinese government assisted to establish shoe and brick industries. In addition, the then Soviet Union gave aid to set up agricultural tool factory.
1972	Birendra became king after the demise of his father.	During Fourth Plan (1970-75), 27 PEs were established.
1980	National referendum was held to choose political system either party less Panchayat system or multiparty system. Party less Panchayat political system won the referendum.	Nine PEs were established during Sixth Plan (1980-85). This plan had policy to 'sell' unprofitable PEs. Chandeswari Textile Industry and Nepal Cheuri Ghee Industry were sold to private sector. Eight rice trading companies were liquidated. In addition some PEs were amalgamated.

Year	Major Political Events	Major Activities with reference to PEs
1985		<p>During Seventh Plan (1985-90), 12 PEs were created.</p> <p>The World Bank examined the condition of Nepalese PEs and found that their performance had deteriorated steady since the early 1980s.</p>
1986	The second general election in Panchayat system to the parliament was held.	Nepal implemented Structural Adjustment Programme (SAP). One of the components of the SAP was privatisation on PEs.
1989		<p>Japan provided assistance to establish cement factory.</p> <p>Privatisation Cell was created within Ministry of Finance.</p> <p>Privatisation Committee was formed to prepare white paper of privatisation.</p>
1990	Multiparty political system was reintroduced.	
1991	The Nepali Congress formed a majority government. It made commitment towards economic liberalisation policy.	One public enterprise was established. Government announced privatisation policy.
1992		Privatisation of three PEs, under phase one, completed.
1993		During second phase (1993-94), government privatised five PEs and liquidated two PEs.
1994	The minority government of Communist Party (United Marxist-Leninist) came to power after mid term poll of 1994.	<p>Privatisation act was passed by parliament.</p> <p>A committee of three MPs was formed to review privatisation programme. Communist government stopped the privatisation process</p>
1995	The coalition government led by the Nepali Congress Party assumed power.	<p>Government announced its intention to implement privatisation policy.</p> <p>During the third phase (1996-97), six PEs were privatised.</p>

Year	Major Political Events	Major Activities with reference to PEs
1997	Coalition government participated by the Communist party assumed power. (March 1997)	Government announced to revise the privatisation policy.
1997	Coalition government led by the Nepali Congress party was formed. (October 1997)	Government formulated policy to privatise 30 PEs during Ninth Plan (1997-2002) period.
1998	The Nepali Congress Party led the coalition government.	Adam Smith Institute, a UK based consulting firm, was appointed by the UK government to assist in implementing privatisation programme.
1999	The Nepali Congress party again formed the government under the leadership of K.P. Bhattarai.	Government renewed its commitment towards the privatisation.
2000	The Nepali Congress party changed its leadership and G. P. Koirala became prime minister. He is the tenth prime minister of Nepal after the restoration of multi party democracy in 1990.	The process of privatisation of four public enterprises has been started.

1. The first part of the paper is devoted to the study of the properties of the function $f(x)$ defined by the equation

$$f(x) = \int_0^x \frac{1}{1+t^2} dt$$

It is well known that this function is the arctangent function, i.e. $f(x) = \arctan x$. The main result of this part is the following theorem:

Theorem 1. Let $f(x)$ be the function defined by the equation (1). Then for any $x \in \mathbb{R}$ the following inequality holds:

$$|f(x) - \frac{x}{1+x^2}| \leq \frac{1}{2(1+x^2)}$$

The proof of this theorem is given in the next section. The second part of the paper is devoted to the study of the properties of the function $g(x)$ defined by the equation

$$g(x) = \int_0^x \frac{1}{1+t^4} dt$$

It is well known that this function is the function $g(x) = \frac{1}{3} \arctan \frac{x}{\sqrt{1+x^2}}$. The main result of this part is the following theorem:

Theorem 2. Let $g(x)$ be the function defined by the equation (2). Then for any $x \in \mathbb{R}$ the following inequality holds:

$$|g(x) - \frac{x}{1+x^2}| \leq \frac{1}{2(1+x^2)}$$

The proof of this theorem is given in the next section. The third part of the paper is devoted to the study of the properties of the function $h(x)$ defined by the equation

$$h(x) = \int_0^x \frac{1}{1+t^6} dt$$

It is well known that this function is the function $h(x) = \frac{1}{5} \arctan \frac{x}{\sqrt{1+x^2}}$. The main result of this part is the following theorem:

Theorem 3. Let $h(x)$ be the function defined by the equation (3). Then for any $x \in \mathbb{R}$ the following inequality holds:

$$|h(x) - \frac{x}{1+x^2}| \leq \frac{1}{2(1+x^2)}$$

The proof of this theorem is given in the next section. The fourth part of the paper is devoted to the study of the properties of the function $k(x)$ defined by the equation

$$k(x) = \int_0^x \frac{1}{1+t^8} dt$$

CHAPTER ONE

INTRODUCTION

1.1 Background

1.1.1 International Context

Activities of states have expanded and contracted at different time periods depending on national and international circumstances. States remained small by modern standards until well into the beginning of twentieth century. A series of dramatic events in the aftermath of World War I marked the turning point. The first was the Russian Revolution of 1917, which led to the abolition there of most private property and put the state in control, through central planning, of all economic activity. The second was the Great Depression of the 1930s, which caused such economic devastation in the non-communist world that states were spurred to experiment with counter-cyclical policies to restore economic activity. The third event, unleashed by World War II, was the rapid break-up of European empires (World Bank, 1997:22).

Most developing countries in Asia, the Middle East, and Africa came out the colonial period with a strong belief in state-dominated economic development. The stress was on the need for active state intervention and state participation to offset these market failures, which led to the expansion of the public enterprise sector and the widespread adoption of economic planning (Cook and Kirkpatrick, 1988:8). By the 1960s states had become involved in virtually every aspect of the economy, administering prices and increasingly regulating labour, foreign exchange, and financial markets (World Bank, 1997:23).

The average contribution of public enterprises to Gross Domestic Product (GDP) in less developed countries rose from 7 percent at the beginning of the 1970s to about 10 percent at the end of the decade. However, there is considerable variation between countries, ranging from 3 percent in Paraguay and Nepal to 38 percent in Ghana and Zambia. In most of the less developed countries, the share of public enterprises investment in total gross fixed capital formation exceeds 25 percent; in some cases it accounts for more than 60 percent of investment (Cook and Kirkpatrick, 1988:5). Public sector was an important sector for employment opportunities in the 1980s. One estimate has suggested that around 44 percent of non-agricultural employment in less developed

countries was in the public sector in the 1980s (Killick and Commander, 1988: 1465). Furthermore, on the basis of sample of 24 developing countries, state-owned enterprises were responsible for producing an average of 10 percent of GDP and 30 percent of investment in 1980 (Berg and Shirley, 1987).

The main export item of developing countries was raw materials. During the late 1970s and early 1980s, prices of raw materials started to decrease. Likewise, the oil shock of the 1970s affected many countries. Developing countries faced the scarcity of foreign aid and a rise in the volume of repayment of foreign loans. These were some of the reasons that led to instability in the economies of developing country. In order to tackle this problem, international financial institutions like the World Bank (WB) and the International Monetary Fund (IMF), introduced Structural Adjustment Programme (SAP) for developing countries. One of the recommendations of SAP was to reduce the role of government by implementing privatisation policy.

In the late 1970s, some western politicians, especially Margaret Thatcher and Ronald Regan, emphasised cutbacks in the size of the public sector. In other words, they implemented the concept of a rolling back the states. Privatisation policy was taken as an important tool to decrease the role of state. Many developed countries implemented privatisation policy and they recommend the same policy for developing countries. In addition, the collapse of the communist system in Eastern Europe and the Soviet Union questioned the dominant role of state in economic activity of a country and gave additional emphasis to an increased the role for the private sector.

Simultaneously, the concept of New Public Management (NPM) emerged in the late 1970s, which tries to apply best management practices of the private sector in order to cope with public dissatisfaction regarding the public sector. It puts emphasis on improving efficiency and productivity in terms of providing government services with less cost and time. One of the dimensions of NPM is privatisation, which has become popular means to reduce the activity of government. Privatisation policy assumes that the activity can be more efficiently and economically carried out in the private sector than in the government sector.

Donor agencies emphasised the implementation of privatisation policy in developing countries. The strong advocacy of the United States government has been particularly important, and this advocacy has percolated not only through United States Agency for International Development (USAID) but also through multilateral and other bilateral donors. A telegram issued by US Secretary of State George Schultz in 1985 to USAID missions laid emphasis on privatisation policy:

Parastatals are generally an inefficient way of doing business. They usually require subsidies and/or preferential treatment. Government should scrutinise the need for and activities of such entities. In most cases, public sector firms should be privatised. Where this is not practical, such firms should in so far as possible be subject to market forces and the discipline of the market place.

USAID subsequently conveyed down a directive requiring most of its African field missions to be involved in "an average of at least two privatisation activities" by the end of fiscal year 1987 (Killick and Commander, 1988:1467).

Furthermore, the World Bank, and its sister organisations, the International Finance Corporation and the Multilateral Investment Guarantee Agency, have actively encouraged privatisation in developing countries. About 70 percent of all structural adjustment loans and 40 percent of sectoral adjustment loans made during the 1980s contained a privatisation component (Cook and Kirkpatrick, 1995:15).

Between 1988 and 1993, there were more than 2600 transactions in 95 countries, yielding \$ 271 billion (Sheshineki and Lopez-Calva, 1998). 1996 was a record year for privatisation; 230 transactions in 57 countries raised \$ 85 billion – a 20 percent increase on 1995 (itself a record year) and over three times the activity of 1990 (Wilson, 1998: 2).

Advocates of privatisation claim that it will lead to improved economic performance as the scope for political interference is limited, the discipline of the private capital market is imposed, and managerial incentives are improved. It is also claimed that privatisation will reduce the budgetary cost associated with inefficiency; in addition, any sale proceeds will directly benefit public finances (Hemming and Ali, 1988:2). There are three kinds of efficiency gains that can be potentially derived from privatisation. These

are gains in allocative efficiency, productivity efficiency, and non-market efficiency (Walle, 1989:604).

The global integration of economies and the spread of democracy have narrowed the scope for arbitrary and capricious behaviour. Taxes, investment rules, and economic policies must be ever more responsive to the parameters of a globalised world economy. Technological change has opened new opportunities for unbundling services and allowing a larger role for markets. These changes have meant new and different roles for government, which is no longer regarded as the sole provider but as facilitator and regulator (World Bank, 1997:2).

Different authors define privatisation in different ways. Privatisation can be understood as (a) all measures that aim at decreasing the role of the state and of increasing the role of the market mechanisms in resource allocation and income distribution and (b) all measures that aim at shifting production activities from the public sector to the private sector (Bjorkman, 2000). Privatisation has taken different forms in different countries. There are many ways to implement divestiture policy. One of the popular forms of privatisation is divestiture. In this modality, government sheds an enterprise or asset. The enterprise or asset is either sold or given away as an ongoing business, or an enterprise may be liquidated.

1.1.2 National Context

1.1.2.1 The State from 1768 to 1999

After the unification of Nepal in the eighteenth century, the concern of government was with consolidating its rule and with battling against rebellious groups. The Sugauli Treaty of 1816, which fixed the political boundaries of the nation, helped to provide the sense of security that allowed the government to be less preoccupied with military affairs and to turn to other things (Bista, 1991:101). In 1846, a big political turmoil and violent tragedy took place in Nepal that helped the Rana family to become political force and they seized power of the monarch. The Prime Minister who emerged after the violent tragedy controlled all the political and administrative affairs of the country. The family

oligarchy lasted over one hundred years from 1846 to 1951. The period is considered as the darkest period in the history of Nepal. The Rana regime never made serious development efforts in Nepal. In 1951, this family autocracy was overthrown and the legal and constitutional power of the monarch was established (Khadka, 1991).

The year 1951 was historic for Nepal. It escaped from isolation and gained exposure to the outside world. This also proved to be the beginning of realisation for transferring the traditional and primitive structure of the economy to gradual modernisation. During 1951-1959, Nepalese politics experienced various governments. Sometimes, cabinets were formed and dissolved; advisory assemblies were established and re-established; parties were created and split (Sheddon, 1987). The idea of economic planning had been accepted early in the 1950s. But, Nepal started planned development efforts by launching its First Five Year Plan only in 1956. The main objectives of this plan were to raise production, employment and standard of living of the people. In 1959, the Nepali Congress party won the election and formed the government. This party attempted to change the socio-economic structure of the country through its commitment and ideology of democratic socialism (Khadka, 1991). But, this government faced internal and external problems, which caused King Mahendra to dissolve the parliament in 1960.

King Mahendra introduced Panchayat as a political system under the constitution of 1962. Principal features of the Panchayat system were party-less politics and absolute monarchy. Indeed, this system was influenced by socialism. This system believed that an active role by the state could help the socio-economic development of a country (Panday, 1999). During this regime, six five year plans were implemented. Progress was made to a certain extent in areas like transport, communication, health, drinking water, literacy and the ratio of student enrollments, but the economic achievements were vague and disappointing on the whole. No economic changes were brought about in the life style of the majority of the population (NPC, 1992).

In April 1990, the partyless Panchayat system collapsed and multi-party democracy was reintroduced. The constitution of 1990 envisages a parliamentary democracy with constitutional monarchy along the lines of the Westminster model (UNDP, 1998). After

restoration of multiparty democracy, the government implemented policy to increase the role of the private sector by implementing liberalisation economy policy. One component of this policy is privatisation.

The Nepali Congress came in power in the general election of 1991 and committed itself to the privatisation of public enterprises as part of an overall programme of liberalisation of the economy. Implementation of privatisation policy started in 1992. By 1994, the government had privatised eight units, liquidated two others and enacted a privatisation act. In the mid-term poll of November 1994, no political party obtained a majority and the subsequent formation of coalition government delayed in the implementation of privatisation. In November 1994, the Communist party formed a minority government that wanted to review the privatisation programme. Although programme was not stopped, there were no further developments until 1996 when a coalition government led by the Nepali Congress party assumed power. Six public enterprises were privatised in 1996 and 1997. In 1999, the Nepali Congress party again returned to power and it announced its intentions to gear up privatisation policy. But, there has been a serious set back in the implementation of privatisation policy. Although, HMG/N has plans to privatise 30 public enterprises during the Ninth Plan (1997-2002) period, thus far the government has not privatised a single public enterprise during this plan period.

A disparity between the rural and urban areas has been growing in Nepal. In fact, development strategy has been focused in some urban areas at the cost of rest of the country. More than 80 percent of the people live in rural areas. Kathmandu, the capital city, is the greatest beneficiary of development activities. It is a centre where decisions are made regarding the appropriation, distribution and realisation of surplus generated by production in rural areas. In other words, the majority of rural areas have been neglected from government plan, programme. Hence, poverty in the rural areas is increasing. The National Planning Commission estimates that 42 percent of population live below the poverty line. It clearly shows that two types of economy exist in Nepal. In urban areas, the private sector can deliver goods and services at competitive prices with minimal state role. In contrast, especially for rural poor people, the state has to play a vital role for the well-being of people who are below the poverty line.

1.1.2.2 Growth and Present Situation of Public Enterprises in Nepal

During the 1950s and 1960s, the private sector of Nepal was very weak. The private sector had low capital investment capability and deficiency of technical knowledge to start industry and services. In this circumstance, public enterprises were established from the infrastructure and service sector to production and even the distribution sector. Public enterprises were established in industry, services, trade, finance and other sectors (NPC, 1992: 689). In addition, looking at Nepal's needs, some countries, especially China and the Soviet Union, provided assistance to initiate industries with their own technology. These countries helped to establish sugar, paper, brick, agricultural tools, and cigarette industries. In 1954, the government established Nepal Bank Ltd. as the first public enterprise by buying its 51 percent shares. After 1954, government established public enterprises in the banking, service and manufacturing sectors. In this way, there were 64 public enterprises before the implementation of privatisation policy.

The World Bank examined the condition of the Nepalese public enterprises in 1985. The Bank found that performance of public enterprises had deteriorated steadily since the early 1980s. Many public enterprises were becoming a serious drain on fiscal resources (World Bank, 1985:30). Given that condition, the World Bank recommended Nepal to implement SAP. Nepal implemented SAP in 1986. SAP proposed sound macroeconomic management, effective management of public finances, support for agriculture and light manufacturing, liberalisation of trade, and a start at reforming public enterprises (World Bank, 1996). Donor pressure, especially that of the World Bank, UNDP and USAID, has been instrumental in accelerating Nepal's privatisation programme since 1988. A privatisation cell was established in the Ministry of Finance in December 1989 to plan and implement the privatisation programme. In this circumstance, implementation of privatisation policy started from 1992 in Nepal.

The Ministry of Finance of His Majesty's Government of Nepal analysed the financial performance of 43 public enterprises and found their financial situation unsatisfactory. Government had invested Rs 14.8 billion as share capital and Rs 44.2 billion as loan

investment in these public enterprises till fiscal year 1997/98. The Rs. 24 million dividend in fiscal year 1997/98 represented a negligible return of 0.16 percent on its share capital (MOF, 1999a:xvi). Financial indiscipline has been increasing in public enterprises. Out of 37 public enterprises (only fully owned by government), only nine public enterprises have up-to-date audited financial statements (DAG, 2000).

Nepalese privatisation plans can be traced back to the Sixth Five-Year Plan (1980-1985). There was little progress during that period. The privatisation process gained momentum after the restoration of multi-party democracy. Government showed its commitment to privatisation policy. In order to implement this policy, it amended the industrial and commercial policy, formulated privatisation policy and implemented a privatisation act. In fact, the main objective of privatisation is to enhance productive use of resources. In 1991, government brought out phase-wise programme of privatisation with the objectives of (1) reducing financial and administrative burden of the government, (2) improving operational efficiency, and (3) involving the participation of general public and private sector in the management of public enterprises (MOF, 1991).

1.2 Focal Problem

The development of public enterprises was intended to contribute to increased production; to provide important basic services; to create employment. But, over the long-term, they have not been able to achieve financial capability or work efficiently and they still depend upon government grants. In other words, public enterprises have not enhanced their efficiency. Looking at the conditions of public enterprises, government started to implement the privatisation policy in 1992. By 1997 the privatisation of 16 Public enterprises had been completed. According to the ruling party, privatisation policy has succeeded in achieving its objective. In contrast, the main opposition party (Communist Party of Nepal) has always opposed privatisation and wants to delay its implementation. Although, the business community supports privatisation in principle, it is not satisfied with the process and impact of privatisation policy. It has demanded improvement in this policy. Keeping in mind the confusion developed about the

privatisation policy as a process and as an outcome, this study has focused on the procedure and impact of privatisation policy in the Nepalese context.

1.3 Objective and Question of Research

The main objective of research is to evaluate the impact of divestiture policy in Nepal as a case of privatisation. To support this focal objective, the specific functional objectives are:

- to assess the performance of privatised enterprises
- to evaluate the efficiency of privatised enterprise.
- to identify the challenges of the privatisation process such as employment, transparency

The main research question is "*Whether the divestiture policy succeeded in achieving its micro and macro level objectives*". The hypotheses to clarify the main question are as follows.

- Divestiture policy assists to reduce financial burdens of the government.
- Divestiture policy contributes to enhancing the efficiency of enterprises.
- Divestiture policy facilitates popular participation in management.

1.4 Research Methodology

Privatisation policy is evaluated quantitatively and qualitatively. Performance of privatised enterprises is measured quantitatively and policy matter is assessed qualitatively. The analysis of this study relied on secondary data published in reports, journals, books, the internet and newspapers.

1.5 Limitation of Study

Privatisation has been defined in various ways. In the broader sense, privatisation emphasises a smaller role for the state and larger role for the market mechanism in

resource allocation and income distribution. In a narrow sense, it means divestiture that is the transfer of government assets and activities to the private sector. This is the focus of study.

This study is based on reports published by the concerned authorities, journals and other relevant publications. Data sets prepared by the Department of the Auditor General, Ministry of Finance and Council of Retired Public Servants have been utilised. Findings of this research therefore heavily depend on the above- mentioned information.

CHAPTER TWO CONCEPTUAL FRAMEWORK

2.0 Introduction

In the previous chapter, an attempt has been made to develop the background of study. It covers international and national context, the focal problem, objectives and limitations of the study. Chapter two gives a conceptual framework of privatisation. This includes the historical perspective, concept, rationale, objectives and modalities of privatisation.

2.1 Historical Perspective

The word privatisation appeared in standard dictionaries only in the early 1980s. It appeared in Webster's New Collegiate Dictionary in 1983 (Ramamurti, 1991:7) narrowly defined as "to make private, especially change (as a business or industry) from public to private control or ownership". However, Peter Drucker coined the term 'reprivatise' in the late 1960s. He contended that government ought to 'reprivatise' and to separate decision-making in areas of public policy from the execution of service provision. It ought, in Drucker's mind, to return as many activities as possible to the private sector (Hodge, 2000:13). Nevertheless, concepts like private property, private ownership and private control have been known for a long time.

The current wave of privatisation follows a long period characterised by nationalisation and growth of the size of the public sector in the economy. Like today's privatisation, nationalisation occurred in practically every area of economic activity and in a great majority of countries. The United States is among the few countries that was only marginally affected by the trend (Guislain, 1997:3).

Privatisation emerged as a policy option in the 1970s, but the concept of privatisation is not new. The great trading companies of the early period of European empire building, such as the British South Africa Company and the Dutch East Indies Company, were in private hands until they were taken over by government as part of the rise of global foreign policy interests in the imperialism of the nineteenth century (Cowan, 1990:6). The private sector has delivered "public services" and helped build infrastructure in Western industrial nations

for several hundred years. In North America, for instance, private firms had contracts to clean the streets of New York as early as 1676, a hundred years before the American Revolution. Throughout the history of the United States, private organisations have been heavily involved in building toll roads, turnpikes, canals, waterways, railways and airports. Private sector partnerships with government were common in Europe in the first half of the twentieth century (Rondinelli, 1995:4)

In *The Wealth of Nations*, Adam Smith favoured privatisation over two centuries ago. He preferred privatisation for its efficiency and productivity aspects. The idea is that private ownership has advantages over public ownership in terms of being inherently more efficient. In 1776, he wrote:

“In every great monarchy in Europe the sale of the crown lands would produce a very large sum of money, which, if applied to the payment of the public debts, would deliver from mortgage a much greater revenue than any which those lands have ever afforded to the crown....When the crown lands had become private property, they would, in the course of a few years, become well improved and well cultivated.” (Vickers and Yarrow, 1988:1)

Modern privatisation programmes are associated with the Thatcher government in the United Kingdom. However, limited privatisation programmes were implemented in some developing and developed countries before that. The government of West Germany in 1959 arranged what was probably the first 'modern' public privatisation offer, with the sale of a block of shares in Preussag (an electricity and mining company) to the public. This was followed by a public offer of shares in Volkswagen - a privatisation that attracted 1.5 million shareholders. These moves, though adventurous in conception and significant in scale, never developed into a coherent political and economic programme capable of catching the popular imagination (Latwin, 1988:8). The Chilean government started a privatisation programme in 1974, more than a half decade before the British initiation. In Chile, 133 enterprises were sold from 1974 to 1982. Likewise the government of Pakistan denationalised 200 cotton ginning, rice husking and flour mills in 1977 (Berg and Shirley, 1987:28).

Since the Thatcher-led privatisation programme in the United Kingdom began in 1979, many developed and developing countries have initiated similar programmes. Between 1988 and 1993, there were more than 2600 transactions in 95 countries, yielding \$ 271 billion

(Sheshineki and Lopex-Calva, 1998). 1996 was a record year for privatisation; 230 transactions in 57 countries raised \$ 85 billion – a 20 percent increase on 1995 (itself a record year) and over three times the activity of 1990 (Wilson, 1998: 2).

Today, privatisation is being carried out by governments of all ideological types, including communist Cuba, Labour governments in Australia and New Zealand, populist and social-democratic governments in Argentina and Mexico, and capitalist democracies like the United States (Miller, 1997). Former communist countries in eastern and central Europe and the former Soviet Union implemented privatisation policy to restructure the economy.

2.2 Definition of Privatisation

‘Privatisation’ is an umbrella term for a diverse set of policies, albeit linked through an underlying judgement in favour of strengthening the ‘market’ at the expense of the ‘state’ (Heald, 1984a:21). On the other hand, the term “privatisation” has been used to refer to any shift in activity from the public to the private sector (Hemming and Mansoor, 1988:6). Thus, privatisation involves the wide range of policies designed to reduce the scope, limit the functions and generally weaken the influence of the public sector (Wright and Perrotti, 2000: xv). Furthermore, Feigenbaum and Henig (1997) explained privatisation as the opposite of state growth.

In the broader concept, the term privatisation essentially denotes marketisation or bringing the enterprise under the disciplines of the market (Ramanadham, 1991: 395). On the other hand, to privatise means to rely more on the private institutions of society and less on government to satisfy people's needs (Savas, 1990:345). Likewise, Kay and Thompson (1986) define the term privatisation "to cover several distinct, and possibly alternative, means of changing the relationship between the government and private sector". Moreover, Young (1986) used the term privatisation to describe a set of policies that aim to limit the role of the public sector, and increase the role of the private sector, while improving the performance of the remaining public sector. In addition, privatisation includes policies that encourage private sector participation in public service and infrastructure provision and that eliminate or modify the monopoly status of state-owned enterprises. Governments encourage businesses, community groups, co-operatives, private voluntary associations, small enterprises, and other

non-governmental organisation to offer, or to participate with government in providing, a wide variety of services (Rondinelli, 1996: 250).

Privatisation has been defined in many ways. In popular usage, it means the transfer from the public to the private sector of entitlements to residual profits from operating an enterprise, coupled with any accompanying changes in regulatory policy (Yarrow, 1996: 5). According to Miller (1997), privatisation means relying less on government to meet people's needs for goods and services, and more on private institutions. Berg and Berg (1997) discussed the role of private sector in the context of privatisation. They viewed privatisation as the means to give private actors a greater role in decisions about what, where, when and how to produce goods and services.

Some scholars view privatisation from an ownership perspective. The transfer of government-owned economic activity to private ownership is known as privatisation (Harris, 1992: 205). In the same way, Hemming and Monsoor (1988) define privatisation as "a transfer of ownership and control from the public to the private sector, with particular reference to asset sales". Likewise, Todaro (2000:681) defined privatisation as a process where the transfer of ownership and control from the public to the private sector takes place. In addition, privatisation should be defined as involving the transfer of control (Balassa, 1987:19).

The term 'privatisation' can refer to many different policies whose common purpose is to reduce the influence of the state in the economy and to strengthen the role of market forces. In its broadest interpretation, market liberalisation, deregulation, divestiture (sometimes called denationalisation), and contracting out are all included under privatisation. In other words, privatisation has been defined in various ways. In a narrow sense, it means transfer of government assets and activities to the private sector. In the broader sense, it emphasises an increased role for the private sector and a decreased role for the public sector in economic activities. In this paper, the term focuses more narrowly on divestiture, which covers the transfer of ownership and control of public enterprises to the private sector.

2.3 Rationale of Privatisation

Until the 1970s, public enterprises were considered prime vehicles for the socio-economic development of a country. Given the underdeveloped nature of resources and markets, public production was viewed as essential. In general, private returns to investments were not sufficiently attractive to private investors, and few native entrepreneurs with investable funds were either willing to bear the risk or capable of running modern enterprises. Also, the scale of investment required often exceeded the capital-raising capacity of the indigenous private sector (Hemming and Mansoor, 1988:3). In addition, Cook and Kirkpatrick (1988:18) viewed the establishment of PEs from a welfare perspective. The public enterprise sector was frequently used to create employment, to assist employees through the payment of higher wages and benefits, and to benefit consumers by subsidising the price of public enterprise outputs.

In fact, privatisation is grounded on the changing role of governments in economic development process. Bienen and Waterbury (1989:617) described the emergence of privatisation as a counter-movement to the growth of government that had characterised much of the post World War II period in industrial and developing countries.

The theory of property rights correlates the efficiency aspect of enterprise with ownership. Cook and Minogue (1990:391) observe that a change in the structure of property rights, from complete government ownership to one where management has more direct stake in enterprise's future, will improve the efficiency of operations. Further, they argued that a change of ownership would impose the discipline of capital markets on the enterprise in order to maximise profits and to avoid take-over or bankruptcy. Likewise, Nellis and Kikeri (1989:63) argued that with a change to private ownership, assets become tradeable, the discipline of hard budgets and commercial capital markets is imposed, a market develops for managers, and the managers thus respond to new signals and incentives. Efficiency will improve as managers maximise their profits. And if efficiency does not improve, the enterprise will go out of business, which is an equally tolerable outcome, since the resource previously tied up in low return uses could then be applied to more productive pursuits. These arguments supposed that the private ownership is better than public ownership to increase efficiency.

In the context of the privatisation debate, the neo-classical analysis translates into policy prescriptions directed towards a reduction in the size of the public sector, the removal of government regulation and controls, the fostering of competition, and a greater reliance upon the market and price mechanism for the allocation of resources (Cook and Kirkpatrick, 1988:9).

Principal agent theory generally attempts to find incentive schemes to encourage agents to act in the interests of principals. The economic theory of principal and agent has also been prominent in the debate over public enterprise performance (Cook, 1997:890). This theory believes that managers of private sector enterprises are more motivated than those in the public sector to achieve the goal of organisation. It is assumed that managers in the private sector get more incentives from their principal than do managers in the private sector.

Privatisation is a central prescriptive maxim of the new right and of public choice authors for three major reasons. First, it subjects state agencies to competition from contractors, forcing them to reveal information to sponsors which they would otherwise keep secret under the block budget system - such as the relationship between varying levels of service and total costs. For example, school cleaning may normally be treated as an indivisible good. But going out to tender automatically projects decisions about the trade-off between different cleaning standards and costs into sharp focus. The contract specification has to go into great detail about the service standards required. And contractors may very well query the specification, arguing the small reductions in cleaning standards would offer disproportionate savings, or that a minor funding increase would permit improvements in the service achieved. Second, these authors generally assume that contracting firms are more efficient in meeting well-defined functions, since they are single-purpose organisations and can operate more flexibly than public agencies. Third, privatisation is recommended as a way of breaking up the restrictive practices and monopoly control over innovations exercised by trade unions and professions in the heavily unionised and professionalised public sector (Dunleavy, 1986:16).

The rationale of privatisation can be seen from the point of public finance too. Most of the developed countries were facing deficits and problems of inflation problem during the late 1970s and early 1980s. At the same time, developing countries were facing current account imbalances, external debt and government deficits. Both sets of countries are concerned with deficit reduction and it is the case that over the decade 1975-1985, central government deficits

of industrial and of developing countries together varied within a range of 3 - 5.6 percent of GDP (Bienen and Waterbury, 1989:619). A World Bank study estimates that public enterprises have incurred heavy financial losses. Between 1989 and 1991, public enterprise losses as a percentage of GDP reached 9 percent in Argentina, 8 percent in Yugoslavia, and more than 5 percent, on average, in Sub-Saharan African countries. In addition, in many countries PEs have become unsustainable burdens on the budget and the banking system, absorbing scarce public resources. Government transfers and subsidies to PEs amounted to more than 3 percent of GDP in Mexico in 1982, 4 percent of GNP in Turkey in 1990, and 9 percent of GDP in Poland in 1989 (Kikeri and others, 1992:15). Hemming and Mansoor (1988:2) argued that privatisation will reduce the budgetary cost associated with inefficiency; in addition, any sale of proceeds will directly benefit public finances.

In the 1980s, pressures from donor agencies have mounted to implement privatisation policy. Multilateral agencies like World Bank and bilateral agencies like USAID advised privatisation as an urgent policy option to many developing countries. Shirley (1989:34) illustrated the emphasis of the World Bank on privatisation policy. As of June 1988, there were some Bank operations in 31 countries with major components supporting divestiture. Likewise, USAID circulated a directive to most of its African field missions to be involved in "an average of at least two privatisation activities" by the end of fiscal year 1987 (Killick and Commander, 1988:1467).

There are other factors that also motivate privatisation policy. Observing complaints of developing countries, Killick and Commander (1988:1473) noticed the motive behind the divestiture movement has been a desire to promote a "crony capitalism" from which the relatives, friends and supporter of members of ruling group are the chief beneficiaries. Aharoni (1991:77) presented the case of Chile where the extensive privatisations of the 1970s fulfilled the government's desire to reward those groups that helped to bring it to power. On the other hand, privatisation is also advanced as a weapon for reducing trade union power. Heald (1984:37) noted that one rationale for the emergence of privatisation policy in the U.K. was, at least implicitly, to tame public sector unions.

2.4 Objectives of Privatisation

Many countries carry out privatisation with different objectives. In fact, the context of a country determines the objective of privatisation policy. In the industrialised countries, the primary objective of privatisation is to achieve greater efficiency and competitiveness in an already established framework of an efficient capital market and a strong response from the private sector; in the former communist countries, privatisation is part of a more comprehensive shift to market, while in developing countries the objectives are a mix of the above two that vary from country to country (UNIDO, 1993).

Berg and Berg (1997) point out that the main objectives of privatisation programme are fiscal relief by cutting government subsidies to money-losing SOEs and/or by generating new revenues from their sale; increased enterprise efficiency; increased efficiency of the entire economy through more competitive markets and better allocation of resources across firms and sectors; increased political support and broadened institutional underpinnings for a market-based economy or further liberalization; stronger financial markets; increased investment and the stimulation of entrepreneurship.

Privatisation policy has multiple objectives. Bjorkman (2000) has observed that privatisation policy is implemented to achieve five goals. Privatisation will improve the economic performance of the industries concerned; resolve the persistent problems of management and control (between government and nationalised industries); generate revenue for the treasury; discipline the power of public sector trade unions; and promote a kind of popular capitalism through wider share ownership. Kay and Thompson (1986:19) add that the objective of privatisation is to promote a kind of popular capitalism through wider share ownership.

Yarrow (1996:6) suggests that privatisation as a policy option has been adopted by many countries in order to achieve following objectives:

- a) improving efficiency by increasing competition and allowing firms to borrow from the capital market,
- b) reducing the public sector borrowing requirements (PSBR),
- c) easing problems of public sector pay determination,

- d) reducing government involvement in enterprise decision making,
- e) widening the ownership of economic assets,
- f) encouraging employees ownership of shares in their companies, and
- g) redistributing income and wealth.

During the late 1970s and the early 1980s, many countries faced a financial crisis. Budgetary matters and short term revenue maximisation were high priorities on the government agenda in response to this problem. Likewise, it was a response to the unsatisfactory performance of public enterprises. Looking at the experiences of developing countries, Ramanadhan (1989:420) included the following objectives of privatisation:

- a) to relieve the budgetary strains on the government;
- b) to improve the efficiency of enterprise performance;
- c) to improve the allocational efficiency of investments;
- d) to withdraw from activities more suited to private enterprise, and where the original objectives of a public enterprise are fully achieved or are no longer valid;
- e) to relieve the administrative burdens of government;
- f) to widen indigenous ownership.

Indeed, objectives of privatisation policy can be classified into short term and long term. Objectives such as reducing the government's deficit, raising cash from the sale of PEs or reducing external debt are short-term outcomes of privatisation policy. On the other hand, increasing productive efficiency, absorbing new technology, improving service quality and strengthening private sector's capability in economic activities are the long term goals of privatisation policy.

2.5 Modalities of Privatisation

Privatisation policy has been implemented with different techniques in different countries. In accordance with their context and situation, governments executed different modalities of privatisation. Divestiture has been more popular in Britain and France while contracting out has been the most frequent method in the United States.

Privatisation can operate at many levels. The lowest form of privatisation may involve no more than introducing good business practices in state enterprises through the engagement of a manager or a consultant from the private sector. This is probably the lowest boundary of the term 'privatisation'. Only a slightly higher level might involve minor operations being undertaken by the private sector – cleaning or catering in a state organisation, for example. At the other extreme, the highest level of privatisation would be the sale of 100 percent of the equity in an enterprise to private sector purchases with no special powers over it being retained by the government (Heath, 1989:20).

Privatisation is a broad policy that aims to improve the performance of government agencies, public enterprises and national economy as a whole. Nowadays, most countries are involved in attempts at privatisation policy. It shows that every government realises the need for structural reform in public sector. Activities of public sector can be privatised by using different modalities. The most commonly used modalities of privatisation are:

- | | |
|------------------|---------------------|
| I. Charging | II. Contracting out |
| III. Divestiture | IV. Load shedding |

I) Charging

Charging is the privatisation of the financing of a service that continues to be produced by the public sector (Heald, 1984:38). Governments institute charges to citizen or consumers for the use of public facilities or services that might otherwise be supported through general tax revenues. This is privatisation in the sense that the government aims to make greater use of private resources by charging the full cost of, or a greater proportion of, providing a service and by reducing subsidies and cross-subsidisation (Young, 1986:240).

II) Contracting out

Contracting out is the privatisation of the production of a service that continues to be financed by the public sector out of taxation (Heald, 1984:38). In other word, public officials act as service arrangers, deciding on what needs to be done and soliciting bids from private firms that are willing and able to perform the specified task.

It will contribute to a decrease in value-added generated by the public sector and to a decrease in public sector employment, but it would (at least in principle) not affect the level of public service provision (Bjorkman, 2000).

Approximately 35 percent of all U.S. local governments contract out residential garbage collection, about 42 percent contract out operation and maintenance of bus systems, and about 80 percent contract out the towing and storage of illegally parked vehicles (Henig and others, 1988: 450). In the U.K., the Thatcher government forced the National Health Service to contract out the provision of some non-medical services such as laundry, and several local authorities have contracted out garbage collection and other services to the private sector (ibid: 442).

III) Divestiture

Divestiture means shedding government owned assets or commercial types of activities or enterprises. In the Third World countries, the term 'denationalisation' is often substituted for the term 'divestiture' (Bjorkman, 2000). Heald defines denationalisation as the sale of public sector assets (Heald, 1984:42). The World Bank believes that divestiture can stimulate new private sector activities, help to develop the capital market, and induce more competitive behaviour in general, none of which is readily measurable (World Bank, 1995:38).

Rondinelli (1995) included partial or full sale of ownership of state enterprises; direct sale and stock offerings; liquidation; management or employee buy-outs; and free or low cost distribution of shares as methods for divestment of state enterprises. In addition, Berg and Shirley (1987) included the leases and management contracts activities in divestiture policy.

Leases and management contracts are arrangements whereby private sector management, technology and/or skills are provided under contracts to an SOE or in respect of state-owned assets for an agreed period and compensation (Vuylsteke, 1988:35). It is assumed that efficiency and effectiveness would increase because of private management style.

The use of management contracts and leases is one of the methods of divestiture that transfers the responsibility of management of enterprise to private providers. The World Bank assumes that it will increase the autonomy of management and reduce the risks of political interference in the day to day operations of the public entity (World Bank, 1994:42)

The term management buy-out generally refers to the acquisition of a controlling share in a company by a small group of managers. It often also designates a similar transaction where employees focus particularly on acquisitions by management and work force. For the sake of clarity, the latter transaction is labelled a management/employee buy-out. The leveraged management/employee buy-out involves the use of credit to finance the acquisition, with the assets of the acquired company generally used as security (Vuylsteke, 1988: 30). It is a solution to employment issues where the alternative is liquidation; the management/employee buy-out should minimise lay-offs and the substantial other costs incurred when closing an SOE (ibid:33). Management/employee buy-outs require the presence of competent and skilled management as well as a committed and stable work force. A strong cash flow potential is usually a precondition for obtaining credit for a buy-out (ibid:34).

Privatisation of ownership entails the whole or partial sale of assets (Berg and Berg, 1987). Ownership transfer includes public offering of shares (full or partial), private sale of shares and sale of government or PEs assets.

Liquidation involves terminating an enterprise as an entity and the sale of its assets. Generally this method is applied in non-viable firms.

IV) Load shedding

The transfer of hitherto state functions to the private sector is called load shedding (Heald, 1984:39). Bjorkman (2000) explains load shedding as the form of privatisation that (deliberately and in one move) combines denationalisation and charging. In this modality, the government not only ceases to produce a service but also discontinues its financing.

2.6 Summary

Concepts like private property, private ownership and private control have been known for a long time. However, the term has been modified and redefined according to changing economic environment. In its new form, the management expert, Peter Drucker has coined the term, in the 1960s with word 'reprivatise'.

Privatisation has emerged as a policy option throughout the world. It is a process of transferring the ownership and decision making power of an enterprise from the public sector to the private sector. It aims to reduce the role of government and to increase the role of private sector in economic activities. However, privatisation has been observed in different ways by different authors. It is viewed as a diverse set of policies in favour of strengthening the market at the expense of the state; as any shift in activity from the public to the private sector; as bringing the enterprise under the disciplines of the market; as relying more on private institutions of society and less on government to satisfy people's needs; as the transfer of ownership and control from the public to the private sector; as the transfer of ownership of state owned enterprise to the private sector by the sale of ongoing concerns or by the sale of assets following liquidation etc.

The failure of state owned enterprises, especially in developing countries, to achieve expected objectives has been the crucial factor, which is responsible to adopt privatisation policy. The major objectives behind privatisation are to improve efficiency by increasing competition; to generate revenue for the treasury; to increase participation of general public in economic activities through wider share ownership; to reduce public sector borrowing requirements; to relieve the administrative burden of government.

The major modes of privatisation are charging, contracting out, divestiture and load shedding. The adoption of particular mode of privatisation depends largely upon the commitment of the government towards a market economy and the attitude of the private sector. In addition, economic, political and social contexts are other factors that influence the choice of mode of privatisation. In other words, decision-makers have to consider the condition of both a country and an enterprise before selecting modes of privatisation.

CHAPTER THREE PUBLIC ENTERPRISES IN NEPAL

3.0 Introduction

In chapter two, an attempt has been made to provide a conceptual framework of privatisation. This includes the historical perspective, concept, rationale, objectives and modalities of privatisation. Present chapter will discuss the growth and performance of public enterprises. In addition, it will include the reasons for the privatisation of public enterprises in Nepal.

3.1 Reasons Behind the Establishment of Public Enterprises

There was wide agreement among the development theorists of the 1940s and 1950s that planning was needed to bring about the transition of the less developed countries to modern economic growth. The process of decolonization and the emergence of new states were in fact accompanied by the establishment of numerous national plan agencies, encouraged and often insisted upon by donors, international organisations and particularly by the World Bank (Martin, 1991:40). One of the arguments for public enterprise was that it would facilitate national planning, giving control over the commanding heights of the economy and providing the state with an additional set of instruments through which to achieve its objectives (Killick, and Commander, 1988:1471)

'Public enterprise' refers to government owned (more than 50 percent) and controlled entities which are supposed to "earn most of their revenue from the sale of goods and services, are self-accounting, and have a separate legal identity"; these characteristics distinguish them from ministerial or purely administrative bodies (Nellis and Kikeri, 1989:51). In fact, a public enterprise has two dimensions, the 'public' dimension, which refers to public purpose or social returns (or social obligations such as generation and protection of employment...) and the 'enterprise' dimension, which refers to the commercial functions of the enterprise, the purely financial returns (i.e. profits) (Kumar, 1993:299). On the other hand, Ramamurti (1991a:206) believed that state owned enterprises were created in large numbers in many

developing countries during the past three or four decades with high hopes that they would play a role that neither government nor the private sector could play.

Nepal sought to promote economic development after the opening the country to the rest of the world in 1951. In 1956, Nepal launched its First Five-Year plan to develop the country. Planning has concentrated on attainment of self-sufficiency, a high growth rate, full employment, and eradication of inequalities. In 1960, Nepal adopted the partyless political system generally based on socialistic principles. The provision of publicness in different sectors of economy became crucial, so efforts were concentrated on the expansion and strengthening of the public sector rather than of the private sector (Shrestha, 1990). The government made it a deliberate policy to use public enterprise as the basic vehicle of economic development

Many countries provided assistance to expand the development activities of Nepal after 1950. During the cold war period, the Soviet Union was eager to increase its influence in the Third World. Nepal got assistance from the Soviet Union to establish cigarette, sugar and agricultural tool production industries in the 1960s and 1970s. During that time, India was providing aid in different sectors too. In those circumstances, China was also interested to show its presence in the development activities of Nepal. China assisted in establishing shoe, sugar, paper, textiles and brick industries in Nepal, while Denmark and Japan supported the establishment of some other industries. Indeed, these industries helped to reduce dependency for some consumer goods from other countries. Foreign assistance played an important role in expanding the number of public enterprises. Nearly 20 percent of public enterprises in Nepal were established with the help of foreign assistance.

According to a welfare economics perspective, public enterprises are established in situations where there are economic opportunities that can yield social but not private profits, and in situations where market failures that induce private businesses to act in socially inefficient ways can be corrected at lower cost via state ownership rather than by regulating private firms (Levy, 1988:1199). Public enterprises established from a welfare viewpoint included the Nepal Food Corporation that has been delivering rice in food scarcity areas at a cheap price. Indeed, the government has an obligation to provide goods that have a high social benefit at a price below their costs. On the other hand, some believed that public enterprises would

generate large profits with which they would be able to finance investments in priority sectors of the economy.

In the Nepalese context, public enterprises were established in order to prepare infrastructure services, to produce the required goods in the country and for export, to help in controlling the price situation, to create opportunities for employment, to increase government revenues and to contribute significantly in the national development as well as to assist in the country's economic advancement (NPC, 1992:689). It is clear that public enterprises have been established in Nepal with various objective and rationale.

3.2 Growth of Public Enterprises

Nepal has adopted a mixed economic system where public and private sectors coexist to develop the country. Every five-year plan has defined the role of public and private sector. However, shortages of capital, technical skills and entrepreneurial abilities in the private sector made it necessary for the government to become involved directly in manufacturing and commercial activities. In other words, one of the main reasons behind the growth of public enterprise was the inability of the private sector to fulfil national goals. Promotion of public enterprises started after the initiation of the First Five Year Plan in 1956. Public enterprise in Nepal has existed only since 1954 when the government bought majority of shares of Nepal Bank Limited. At that time, there was only one commercial bank operating in the country.

Table 3.1 shows that the majority of public enterprises were established during the 1960s and 1970s. However, unlike most developing countries, the growth of the Nepalese public enterprises was not based on the nationalisation of private enterprises. In some cases, external donors (including China, the then Soviet Union, Japan, Denmark) helped to establish public enterprises in Nepal. In other cases, units already existing as government departments were converted into public enterprise.

In the late 1970s, the Nepali Carpet and Vegetable Ghee Industries were liquidated. During the Sixth Plan period, Chandeswari Textile Industry and Nepal Cheuri Ghee Industry were

sold to the private sector; Eastern Electricity was absorbed by Nepal Electricity Corporation; Asahaya Kalyan Kendra was absorbed by Balaju Textile Industry; and eight rice trading companies plus two other public enterprises were liquidated. In the late 1980s, the Nepal Timber Corporation and the Fuel Corporation were amalgamated. In addition, the Provident Fund was excluded from the list of public enterprises. Ratna Recording was absorbed by Nepal Television in the early 1990s and 16 public enterprises were privatised during the Eighth Plan period. Before implementation of divestiture policy, the government established the Citizen Investment Fund in 1991.

Table 3.1
Growth of Public Enterprises in Nepal
(1954/55 to 1992/93)

	Plan Period	Addition	Exclusion ⁺	Total
1.	Before First Plan (1954-55)			1
2.	First Five Year (1956-1960)	7		8
3.	No Plan Period (1961-62)	3		11
4.	Second Five Year (1963-1965)	11		22
5.	Third Five Year (1965-1970)	12		34
6.	Fourth Five Year (1970-1975)	27		61
7.	Fifth Five Year (1975-1980)	3	2	62
8.	Sixth Five Year (1980-1985)	9	14	57
9.	Seventh Five Year (1985-1990)	9	2	64
10.	No Plan Period (1990/91-91/92)		1	63
11.	Eighth Five Year (1992-1997)	1	16	48

Source: Manandhar (1998)

The largest numbers of enterprise (24) were in the manufacturing sector, while there were ten in trade, ten in finance and insurance, and 17 in social and service sectors. There were three enterprises under the public utilities sector. Before implementation of the divestiture policy, there were 64 public enterprises in Nepal.

Public enterprises dominate the major sectors of the economy. For example, in 1990, manufacturing public enterprises controlled about 70 percent of domestic cigarette market, 62 percent of the cement market and 61 percent of the sugar market (Sharma, 1995:7). In addition, public enterprises succeeded in generating employment opportunities. During 1975/76 – 1991/92 employment increased three times from 23,133 (Panday, Khanal and Pande, 1988:176) to about 70,000 (Dahal and others, 1999:74).

⁺ Exclusion means liquidation, amalgamation and/or selling of certain public enterprises.

3.3 Performance of Public enterprises

Government established public enterprises in order to achieve certain objectives. Measurements of performance assist in knowing whether the public enterprise succeeded or not in achieving its objectives. More specifically, performance has been interpreted in terms of success in achieving its goals. Performance is linked with the objectives of organisation.

The poor financial performance of public enterprises has had a direct impact on the government budgets. Table 3.2 shows that the funds from the government to the public enterprises have on average increased 22.27 percent annually during 1994/95 – 1998/99 while the flow of funds from the public enterprises to the government recorded only a rise of 14.55 percent during the same period. It clearly shows that public enterprises are a drain of scarce resources than a generator of resources.

Table 3.2
Flow of Funds Between Government and Public Enterprise

Particular	(Rs in Million)					Annual Growth Rate
	1994/95	1995/96	1996/97	1997/98	1998/99	
A. Funds from government to PEs	2780.0	6298.0	7065.1	7562.7	6213.7	22.27
* Share capital	858.7	1553.0	868.2	1839.0	1420.0	13.40
* Loan capital	1272.4	3822.0	5303.3	4658.8	4090.0	33.90
* Operating/Transport subsidy	571.4	726.0	713.6	988.0	698.7	5.16
* Capital subsidy	77.5	197.0	180.0	76.9	5.0	-49.60
B. Funds from PEs to government	3966.7	5330.4	4585.5	4913.3	6830.0	14.55
* Income taxes	860.2	1144.5	1231.0	1317.8	1150.0	7.53
* Dividend	1063.0	1357.9	1134.2	1194.5	1780.0	13.76
* Interest	843.1	1734.0	1357.5	1153.0	1660.0	18.46
* Principal	1200.4	1094.0	862.8	1248.0	2240.0	16.88

Source: Ministry of Finance, 2000.

Nepalese public enterprises have been largely criticised from the viewpoint of financial performance. Government invested huge amounts of capital in public enterprises, but the financial return is not satisfactory compared to the capital employed. While public

enterprises were supposed to generate investable surpluses for government, they actually often posed burdens on government budgets, in many cases amounting to significant sums.

Table 3.3
Profitability of Public Enterprises (1980/81 – 1999/2000)
(Rs in Million)

Year	Capital Employed	Gross Profit	Gross Profit as % of Capital Employed
1980-81	3331.3	-156.0	-4.68
1985-86	7399.0	105.0	1.42
1990-91	35843.2	-1871.7	-5.22
1995-96	62010.9	1377.6	2.22
1999-00*	97341.1	2949.0	3.03

* Estimate

Source: Ministry of Finance, 2000.

Capital investment in public enterprise has increased in substantial proportion. The net capital investment in fiscal year 1999-2000 amounted to Rs. 97.3 billion as compared to Rs 3.3 billion in the fiscal year 1980-1981. Every investor expects satisfactory returns from his investment. However, public enterprises have demonstrated a disappointing inability to fulfil this expectation. The profit earning capacity of enterprise is low. Even from the gross profit viewpoint, these enterprises present a gloomy picture.

Table 3.4
Capacity Utilisation of Selected Public Enterprises

Name of Industries	Annual Production Capacity	(In percentage)				
		1990/91	1996/97	1997/98	1998/99	1999/00*
Birgung Sugar Factory	Sugar 13500 M.Ton	150.18	111.50	58.87	69.54	108.30
	Rectified Spirit 1350000 Lit	78.66	0.02	12.96	20.96	33.19
Janakpur Cigarettes Factory	5.25 Billion Sticks	83.60	32.55	40.00	41.90	43.81
Hetauda Textile Industry	6.2 Billion Meters	43.44	36.59	42.74	17.11	5.03
Himal Cement Factory	108400 M. Ton	79.17	35.95	44.42	37.57	34.72
Hetauda Cement Company	260000 M.Ton	45.54	48.42	52.69	49.55	70.00

* Estimates

Source: Ministry of Finance 2000.

Capacity utilisation is an important indicator to evaluate the performance of enterprise. Indeed, the economic efficiency of an enterprise depends a great deal upon capacity utilisation. It has been well realised that the capacity of an enterprise has to be utilised to its maximum in order to improve performance. However, the capacity utilisation rates of the

Nepalese public enterprises have not been increased significantly during the past few years. Table 3.4 shows the capacity utilisation rates of selected public enterprises.

The capacity utilisation of some public enterprises, especially textile, cigarette, cement, is found to be low. In fact, optimum capacity utilisation would help to achieve the objective of cost minimisation. As a result of the lower capacity utilisation, the financial performance of public enterprise in general has been adversely affected.

Government realised that public enterprises succeeded in creating employment opportunities, increasing production and providing important basic services. However, public enterprises did not function in an efficient manner. Despite the long-term protection, public enterprises have not been able to achieve financial capability nor work efficiency and they still depend upon government grants (NPC, 1992).

Weak financial position and unsatisfactory financial performance have made the huge government investment unproductive and the return on investment shows a diminishing trend (MOF, 2000:78). At the same time, financial indiscipline has been increasing in the public enterprise sector. The Auditors General's Report of 2000 revealed that out of 37 public enterprises (fully government owned), only nine public enterprises have up-to-date audited financial statements.

3.4 Reasons for Privatisation/Divestiture in Nepal

Privatisation is seen primarily as a means of improving the efficiency of enterprises. Because it is believed to limit the scope for political interference in decision making, to increase managerial incentives by making managers responsible to shareholders who will monitor their performance better than governments, and to impose the financial discipline of private capital markets (including the market for corporate control), there is likely to be an incentive to seek productive efficiency, and fewer barriers to attaining it (Hemming and Mansoor, 1988:6). Governments around the world are privatising state-owned enterprises in an effort to improve their efficiency and to lessen the financial burden they often represent for taxpayers (Kikeri and others, 1992:13)

The Thatcher-led government of the UK implemented privatisation as a major tool of economic policy. The main focus of this programme was to cut back the size of the public sector. In fact, privatisation was taken an important instrument to trim the public sector. In addition, the collapse of the communist political system in Eastern Europe and the Soviet Union also produced argument against the active role of state in economic activity. Likewise, multilateral and bilateral donor agencies observed public enterprises as a burden on the national economy. Todaro (2000:681) mentioned that during the 1980s and 1990s, major international bilateral (USAID) and multilateral agencies (WB, IMF) actively promoted privatisation. In these circumstances, most developing countries got pressured by donor agencies and started to implement privatisation policy after the 1980s.

The World Bank examined the condition of Nepalese public enterprises in 1985. The Bank found that the performance of public enterprises had deteriorated steadily since the early 1980s. Many public enterprises had become a serious drain on fiscal resources (World Bank, 1985:30). In that condition, the World Bank recommended Nepal to implement a Structural Adjustment Programme (SAP). Nepal implemented SAP in 1986. One of the components of the SAP was to privatise public enterprises (World Bank, 1996). In fact, donor pressures, especially by the World Bank, United Nations Development Programme and USAID, were instrumental in accelerating Nepal's privatisation programme since 1986 (CRPF, 1995:11).

Despite huge capital investment, public enterprises in Nepal did not obtain satisfactory financial returns on the capital employed. During 1980/1981 - 1999/2000 the overall investment increased about 29 times from Rs 3.3 billion to Rs 97.3 billion. However, the levels of profitability remained either very low or negative (Ministry of Finance, 2000:32). Realising poor performance, the government introduced policies to improve their performance from the early 1980s. The Sixth Plan (1980-85) identified the problems of public enterprises and formulated a programme to reform this sector. Government introduced performance incentives based on progress monitoring and autonomy for management. This reform programme proposed to expose public enterprises to domestic and external competition. However, the reforms were difficult to implement both technically and politically. While the government borrowed from the Asian Development Bank in order to improve the performance of some

public enterprises, these attempts did not improve the performance of public enterprises. The continued worsening performances of public enterprises in the country put a severe drain on government resources. Public enterprises have been a burden to the government and this had been the primary motive for adopting privatisation programme in the country. The most common trigger for privatisation is fiscal pressure.

In Nepal, after the restoration of multiparty democracy in 1990, the process of liberalisation of the economy started. In 1991, the newly elected government made a commitment towards a comprehensive privatisation programme as a part of the country's overall economic liberalisation policy. At that time, the government of Nepal showed its political commitment to initiate privatisation programme on a long term basis in that time.

3.5 Summary

Government established public enterprises to prepare infrastructure, create employment opportunities, produce goods and services, control price situation, produce goods for exports, increase revenues to the government and accelerate industrialisation for economic development. Public enterprises have been promoted since the beginning of the First Five Year plan. Most public enterprises were established during the 1960s and 1970s. About 20 percent public enterprises were established with the financial and technical assistance of donors, such as China, the then Soviet Union, Denmark, Japan etc.

These enterprises have been playing a dominant role in the major sector of the economy. In addition, they assisted in industrial and professional development of country. During 1980/81-1999/2000, the overall investment increased 29 times. However, the level of profitability remained either very low or negative. The capacity utilisation level remained low. As a result of poor financial performance, the public enterprises have been increasingly perceived as a liability instead of an asset to the nation. Despite long term protection, these enterprises neither have been able to achieve satisfactory financial capability nor to work efficiency. Most of the public enterprises still depend on government grants. One of the motivating factors for the privatisation of public enterprise is poor performance of these enterprises. Pressure of donor agencies is another reason to implement privatisation policy.

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CHAPTER FOUR IMPLEMENTATION OF DIVESTITURE POLICY IN NEPAL

4.0 Introduction

Chapter three examined the performance of public enterprises in Nepal. It covers the evaluation of public enterprises in terms of financial and economic performance. This chapter presents the early privatisation attempts and discusses the present scenario of privatisation of public enterprises in Nepal. It covers the policies and programmes adopted by the government in this regard.

4.1 Efforts of Privatisation Before 1992

The Sixth Five Year Plan (1980-85) realised the need of performance evaluation of public enterprises. It spelled out a divestiture policy for public enterprises. The plan recognised that the main reason for poor performance of public enterprise was the lack of a definite policy. During the Sixth Plan period, a public enterprise policy was formulated to initiate the participation of the private sector in the national economic development. The policy clarified that enterprises with similar natures and objectives would be merged. Furthermore, it specified that those enterprises that do not fall into the government activities would be transferred to the private sector (NPC, 1980:32). In 1981, the government liquidated eight rice trading companies. The Sixth Plan provided ground to sell unprofitable public enterprises. However, the achievement was below expectations. During the plan period, two public enterprises, namely Chandeswori Textile Industry and Nepal Cheuri Ghee Plant, were sold to the private sector (SCOPE, 1997:4).

In 1984, the government floated shares of the National Insurance Corporation in order to encourage public participation in share ownership. Government fixed Rs 450 as the price as against Rs 100 value of share. But, the government was unable to sell more than half of the shares, which it were offered to the general public. Despite a good performance record and profitability of this enterprise, it experienced under-subscription for its shares because of

excessive premium charges (Panday, Khanal and Pande, 1988:169). Likewise, in 1985, the shares of the Rastriya Banijya Bank and the Nepal Industrial Development were floated in the market. Again, public response was very poor. The mentioned causes were over-valuation of the shares, a maximum limit on the subscribers of shares, and the limit on time duration for subscription. However, the major cause was the lack of preparation on the part of the government with regard to the divestiture process (Manandhar, 1998:87). It showed that attempts of government to implement divestiture policy could not succeed at that time.

Divestiture of PEs to the private sector also received a prominent place in the public enterprise policy that was elucidated in the Seventh Plan (1985-90). In 1988, government made an attempt to sell Balaju Textile Industry to a single buyer. However, it could not be sold due to the lack of proper valuation of assets and business (Shrestha, 1996: 7). Likewise, in 1988, government had taken the decision to sell 49 percent shares of the Birgunj Sugar Mill. And, in 1989, government decided to privatise 50 percent of the shares in 30 public enterprises so a privatisation committee was formed. The said committee submitted a draft white paper and programme relating to privatisation. However, the government did not take action in the direction of privatisation (NPC, 1992:690). Thus, privatisation initiated in the beginning did not succeed due to lack of real commitment to the privatisation process on the part of previous government, absence of relevant experience within the bureaucracy and the lack of technical expertise within the public service (Shrestha, 1996:7).

4.2 Policies Towards the Privatisation

4.2.1 Privatisation Policy

In 1991, government made a major commitment towards a comprehensive privatisation programme of public enterprise as part of the liberalisation of the economy. This illustrated a marked departure from the previous government policy of undertaking economic development with very little emphasis on the role of private sector. In order to implement privatisation policy, the elected government formed by the Nepali Congress party after the political change in 1991 brought a phase-wise programme of privatisation. Government announced the following objectives for the programme:

- 1) to reduce the financial burden and administrative responsibilities of the government,
- 2) to enhance operational efficiency, and
- 3) to involve participation of general public and private sector in the management of public enterprises (MOF, 1991).

As the government felt the need for a broad economic reform, privatisation was considered as a major policy option. A policy paper on privatisation was published in 1991 to privatise public enterprises. It laid down the institutional arrangement, modalities and procedure for the privatisation of public enterprise.

4.2.2 Industrial Policy 1992

The 1992 Industrial Policy clearly stated that most of the industries established in the public sector would be transferred to the private sector in order to increase the role of private sector in the industrialisation of country. In addition, the policy assured that no industry established in the private sector would be nationalised. In its operating policy, section 3.14 of the policy stated the strategy of gradually transferring the public sector enterprises to the private sector (MOI, 1992:4).

4.2.3 Commercial Policy 1992

The 1992 Commercial Policy also mentioned the objective of increasing the participation of the private sector. It sought the creation of an open and liberalised economic environment in order to develop the domestic and international trade. Section 2.6 of the policy stated that commercial enterprises operated in public sector would be gradually privatised in accordance with the capacity and development of the private sector (MOC, 1992:2).

4.2.4 Privatisation Act 1994

In order to accelerate the pace of privatisation, a Privatisation Act was passed in 1994. The act sought to increase productivity through the enhancement of efficiency of state owned enterprises in the kingdom of Nepal, and thereby to transfer migrate the financial

administrative burden from the Government and to usher in an all-round economic development of the country by broadening the participation of private sector in the operation of such enterprises (MLJ, 1994).

4.2.4.1 Institutional Arrangements

The act included a provision to form a Privatisation Committee (PC) to privatise the public enterprises. Composition of committee is presented in annex one. The act provides the powers, function and duties of the committee, which is presented in annex two.

4.2.4.2 Modalities of Privatisation

The Act clearly mentioned that government may privatise any enterprise that has been classified for privatisation in pursuance of any or all of the following processes:

- a) by formation of co-operatives;
- b) by selling assets of the enterprise;
- c) by leasing out the assets of the enterprise;
- d) by involving private sector in the management of the enterprise; and
- e) by adopting any other modalities considered appropriate by government on the basis of the recommendation of the committee (MLJ, 1994).

Furthermore, the Act made provision for the proposals for privatisation, evaluation of the proposals, settlement of disputes, provisions relating to employees, liquidation of enterprises and other arrangement.

4.2.5 The Eighth Plan (1992-1997)

The Eighth Plan came up with a determination to adopt divestiture policy on a large scale. In addition, it sought to strengthen the public enterprises. With regard to the public enterprises, the Eighth Plan mentions the objective of enhancing the efficiency and competitive ability of corporations and thus increasing their productivity through the promotion of cooperatives.

The plan also initiated a programme to increase efficiency in both types of corporations those that are not to be privatised and those that are to be privatised in future.

The Eight Plan formulated the following policies:

- a) Corporations of industrial and business nature will be gradually privatised. All policies and programmes relating to privatisation will be made transparent.
- b) In the process of privatisation of corporations or in implementing efficiency enhancing programmes the current employees will also be included as far as possible. But if the number of employees/labourers are more than necessary, they will be removed only after providing adequate compensation.
- c) A legal basis will be prepared for the privatisation of corporations after considering their structure. Those corporations established through special legal provisions will be handed over through the company laws and privatised (NPC, 1992:693).

4.2.6 The Ninth Plan (1997-2002)

The Ninth Plan also emphasised the privatisation programme. It has outlined the main objective of privatisation as to enhance productive uses of resources in view of economic, social and political realities of the country. The Ninth Plan has set the following policies and strategies to achieve objective of privatisation.

- a) Privatisation will be undertaken in a consensual environment by keeping people well informed about both the positive and adverse consequences associated with the process. All information will be made public and the programme will be implemented by ensuring maximum participation of the people. Transparency is required in all transactions.
- b) The selection of investor will only be made after careful assessment of business skills and experience, financial status, resources, access to markets and business plans for the enterprise. Potential investors will be provided with all information about the enterprise. Terms and conditions of transfer will be explicitly laid down. Foreign investment will be encouraged where capital and technology is needed.

- c) The business value determined by competitive marketing is accepted as the price. The business value of the enterprise will be widely disseminated.
- d) Regulatory laws and institutions will be set up prior to the privatisation of monopolies. (NPC, 1998:184).

It mentioned privatisation as an important policy to increase the participation of people in the economic development of the country. In this plan period, government has made plans to privatise 30 public enterprises. In fact, this number is nearly 60 percent of the remaining public enterprises.

4.3 Process of Privatisation

The Privatisation Act provides steps of the privatisation process, which can be divided into three sub-headings.

4.3.1 Selection of the Enterprise

The line ministry, the management of the concerned public enterprise, the privatisation committee or the Ministry of Finance may initiate the selection of an enterprise for privatisation. The privatisation committee makes recommendations to select and approval is given by the Cabinet through Ministry of Finance to start privatisation process for that enterprise. The initiation of the privatisation of public enterprise, according to act, must be publicised in the official gazette.

4.3.2 Evaluation of Enterprise

An assessment of the enterprise is to be carried out on the basis of the assets of the enterprise, the market price of its shares, the profit and loss of the enterprise, and its potential for future production, sales, profit and loss. The privatisation committee makes recommendations to the cabinet through Ministry of Finance. After getting approval from the Cabinet, the preparation of an information memorandum and bid process is started. The bid notice is published in a

national newspaper giving necessary details of such enterprise in conformity with international practices.

4.3.3 Evaluation of Bids

The act listed the evaluation criteria for bids received from potential buyers. These include attractive price, continuation of the nature of business, retention of the service of present workers and employees, managerial experience, enhancement in the employment opportunity, expansion of the enterprise and business by preparing a good business plan and making additional investments. Furthermore, if two or more proposals are similar, then proposals submitted by Nepalese investors will get priority. Negotiation teams assess the technical and financial bids separately and submit final findings to the privatisation committee. Then, privatisation committee presents it to the Ministry of Finance. The Cabinet makes a final decision on the recommendation of the Ministry of Finance. The terms and conditions of privatisation, according to the act, should be published within one month of the agreement being signed.

4.4 Implementation of Divestiture Policy

In 1991, government announced a phase-wise approach to implement divestiture policy.

4.4.1 The First Phase (1992)

Three public enterprises were privatised in the first phase. During this phase, the Bhrikuti Paper Mills (BPM), the Harisiddhi Brick and Tile Factory (HBTF) and the Bansbari Leather and Shoe Factory (BLSF) were privatised.

Table 4.1
Enterprise Privatised in the First Phase

Enterprise	Sector	Main Activities	Privatisation		Sale Proceed (Rs in million)*
			Method	Year	
BPM	Manufacturing	Paper	Sale of Assets	1992	229.80
HBTF	Manufacturing	Brick and tile	Sale of Assets	1992	226.90
BLSF	Manufacturing	Processed Leather & Shoes	Sale of Assets	1992	22.40

Source: Ministry of Finance, 1999

* price of management share only

These privatised enterprises had been established with technical and financial assistance of China. The government privatised these public enterprises through the sale of assets by public tender (MOF, 1999:14). The first phase of the privatisation programme was completed in November 1992.

4.4.2 The Second Phase (1993-1994)

As the government implemented the first phase of the privatisation programme, it sought a long-term privatisation programme that considered the strengths and weaknesses of past experiences.

The high level privatisation committee recommended 27 public enterprises to be privatised based on the long term privatisation programme and the recommendation of the privatisation cell. The council of ministers decided to privatise all suitable public enterprises in five phases and also to continue the enterprise reform and restructuring wherever possible. At that time, the government decided to privatise 14 public enterprises by September 1994. As a part of the second phase of the privatisation programme, five public enterprises were privatised. They were the Nepal Film Development Company (NFDC), the Balaju Textile Industry Ltd (BTI), the Raw Hide Collection and Development Corporation Ltd (RHCDC), the Nepal Lube Oil (NLO) and the Nepal Bitumen and Barrel Industry Ltd (NBBI). In addition, the Nepal Jute Development and Trading Company (NJDTC) and the Tobacco Development Company (TDC) were liquidated in this phase.

Table 4.2
Enterprises Privatised in the Second Phase

Enterprise	Sector	Main Activities	Privatisation		Sale Proceed (Rs in million)*
			Method	Year	
NFDC	Service	Film Production & Process	Share Sale	1993	64.66
BTI	Manufacturing	Textile Production	Share Sale	1993	17.72
RHCDC	Trade	Trading of raw hide	Share Sale	1993	3.99
NBBI	Manufacturing	Bitumen & Emulsion production	Share Sale	1994	11.64
NLO	Manufacturing	Lubricants Production	Share Sale	1994	30.42
NJDTC	Trade	Promotion & Trading of Jute	Liquidation	1993	--
TDC	Trade	Promotion & Trading of Tobacco	Liquidation	1994	--

Source: Ministry of Finance, 1999

* price of management share only

The government revised the modality of privatisation in the second phase. In the first phase, the government had adopted the 'sale model' which revealed various problems, such as unavailability of data for valuation of current assets on cost or reliable value basis, occurrence of undisclosed liabilities due to incomplete and poorly managed books of accounts, unaccounted employee liabilities, untraceable debtors, over-valued current assets etc (Sharma, 1995:48). The modality of the second phase of privatisation was the sale of block shares by public tender. The shares were valued on net assets the valuation method (ibid:49).

While 14 public enterprises were proposed for privatisation in the second phase, only five enterprises were privatised and two enterprises were liquidated. The main cause for the delay in implementation was a change in the government. The Communist Party came into power in November 1994. The economic policy of the communist government stated that " while pursuing privatisation policy a selective approach will be followed. In this regard, selected public enterprise, not suitable to be retained in the government sector, will be transferred to the private sector. As the privatisation processes and the priority settings followed in the past were not appropriate, initiatives have already been taken to review the overall privatisation process" (CRPS, 1995:14).

The privatisation programme was subject to close scrutiny during the period of communist government. It was on the premise that the privatisation process and the priority settings in the past were not appropriate. The government postponed further action on it. The privatisation programme was set aside and its thorough review was proposed. Though the programme was not dropped altogether, it did not receive any active consideration either. As a result, the privatisation drive was not only discontinued but also the role of the private sector vis-a vis public enterprises in economic ventures became obscure (SCOPE, 1997:4).

4.4.3 The Third Phase (1996-1997)

In September 1995, after another change of government (a coalition of three parties), the policy of selective privatisation taken at the time of communist government was reversed. The government made a new schedule and took necessary actions for selecting public enterprises as the candidates for privatisation. From 1996 March to August 1997, the Nepal

Foundry Industry (NFI), the Raghupati Jute Mills (RJM), the Biratnagar Jute Mills (BJM), the Nepal Bank Ltd (NBL), the Agricultural Tools Factory Ltd (ATF) and the Bhaktapur Bricks Factory (BBF) were privatised.

Table 4.3
Enterprises Privatised in the Third Phase

Enterprise	Sector	Main Activities	Privatisation		Sale Proceed (Rs in million)*
			Method	Year	
NFI	Manufacturing	Cast Iron , Tools, Spare Parts	Share Sale	1996	14.47
RJM	Manufacturing	Jute Processing & Production	Share Sale	1996	82.20
BJM	Manufacturing	Jute Processing & Production	Management Contract	1996	N. A.
NBL	Financial	Banking Operation	Share Sale	1997	125.14
ATF	Manufacturing	Agriculture Tools Production	Share Sale	1997	95.10
BBF	Manufacturing	Bricks & Tile Production	Lease	1997	20.30

Source: Ministry of Finance, 1999

* price of management share only

Out of the above public enterprises, Biratnagar Jute Mills was given to a private party on management contract for five years. Bhaktapur Bricks Factory was given on lease for 10 years. Shares of Nepal Foundry Industry, Raghupati Jute Mills and Agricultural Tools Factory were sold to the management and the public through tenders. Shares of Nepal Bank Limited were partially sold to the public and to the employees of the bank itself.

Again, the Nepali Congress party returned to power in 1999 and it announced its intention to gear up the privatisation policy. However, although the government planned to privatise 30 public enterprises during the Ninth Plan (1997-2002) period, there has been a serious set-back in the implementation of the privatisation policy. Thus far the government has not privatised a single public enterprise during this plan period.

Yet, government is determined to implement privatisation policy. It has established the necessary legal framework. In addition, policy adjustment has been made favourable to the privatisation policy. However, the pace to implement the programme has been comparatively slow. Frequent changes in the government can be identified as one of the major reasons. Furthermore, opposition from the various interest groups can be identified as another reason.

4.5 Summary

The Sixth Five Year (1980-85) promulgated a policy about the privatisation of public enterprises. The government sold two public enterprises to the private sector during the Sixth Plan. In addition, in 1981, eight rice trading companies were liquidated. At the end of this plan, government floated shares of some public enterprises. At that time, government attempted to implement a privatisation policy. The Seventh Plan (1985-1990) became more explicit in its approach towards privatisation policy. In 1989, government planned to privatise 50 percent of its shares in 30 public enterprises. However, due to incomplete and faulty preparation, the efforts of implementation of divestiture did not succeed. In 1991, the government made a commitment towards the privatisation of public enterprises as a part of an overall programme of liberalisation of the economy. Thus privatisation was considered as a major policy option. Keeping this in view, a Privatisation Policy, an Industrial Policy and a Commercial Policy were published. Likewise, the Eighth Plan announced its firm determination to adopt privatisation policy. In 1994, a Privatisation Act was introduced to speed up the pace of privatisation. The Act made institutional arrangements in this regard. The process of privatisation was specified. In addition, the Act made provision for the proposal, settlement of disputes and liquidations of enterprises etc.

During first phase of privatisation that ended by 1992, three public enterprises were privatised through the sale of assets. Five public enterprises were privatised and two public enterprises were liquidated in the second phase of privatisation. And in the third phase six public enterprises were privatised. The Ninth Plan has also formulated objectives, policies, programmes and strategies to give an effective boost to the privatisation policy. Thirty public enterprises have been selected for privatisation during this plan period.

Government is determined to privatise public enterprises. In this context, the necessary legal framework has been formulated. Further, policy adjustments have already been made that are favourable to the privatisation policy. However, the pace of implementation is comparatively slow.

CHAPTER FIVE

EVALUATION OF THE IMPACT OF DIVESTITURE POLICY

5.0 Introduction

The preceding chapter examined the implementation of divestiture policy in Nepal, including efforts of privatisation before 1992, policies of privatisation since then and different phases of implementation. Chapter five will analyse the impact of divestiture policy in micro and macro level. The micro level impact of privatised enterprises will be analysed in terms of production, sales, profits and productivity. Likewise, the macro level impact of divestiture will be studied in terms of subsidies, employment, pricing, ownership distribution and participation of private sector in divestiture programme.

5.1 Overview of Privatised Enterprises

In the five year period, from 1992 to 1997, the government of Nepal privatised 16 public enterprises. These enterprises were diverse. Three enterprises, Bhrikuti Paper Mills, Harisiddhi Bricks and Tile Factory and Bansbari Leather and Shoe Factory, were privatised under the first phase in 1992. Likewise, five enterprises Nepal Film Development Corporation, Balaju Textiles Industry, Raw Hide Collection and Development Corporation, Nepal Lube Oil and Nepal Bitumen and Barrel Industry were privatised under the second phase (1993-94). In addition to five public enterprises, Nepal Jute Development and Trading Company and Tobacco Development Company were liquidated in this phase. In third phase, six public enterprises, Nepal Foundry Industry, Raghupati Jute Mills, Biratnagar Jute Mills, Nepal Bank Limited, Agricultural Tools Factory and Bhaktapur Bricks Factory were privatised in 1996-97.

The government adopted different modalities of divestiture. In phase one, enterprises were privatised through the sale of assets. In phase two, share of sales and liquidation modality of divestiture were selected. In phase three, in addition to share sale, government applied management contract and lease method of divestiture.

Most of the enterprises, eleven units, were in the manufacturing sector producing paper, bricks, shoes, textiles, bitumen, lubricants, cast iron, jute and agriculture tool. Four enterprises were related with trading sector and one enterprise was associated with financial sector.

In terms of company size, there were smaller enterprises like Nepal Foundry Industry, Nepal Bitumen and Barrel Industry to large industries like Bhrikuti Paper Mills and Harisiddhi Bricks and Tile Factory. From the viewpoint of employment, these enterprises ranged from 65 in Nepal Foundry Industry to 1321 in Bhrikuti Paper Mills (DAG, 1998:12). Four enterprises, namely, Bhrikuti Paper Mills, Harisiddhi Bricks and Tile Factory, Bansbari Leather and Shoe Factory and Bhaktapur Bricks Factory were established under the foreign assistance of China. In addition, the then Soviet Union provided assistance to establish Agricultural Tools Factory. Three enterprises, Nepal Bitumen and Barrel Industry, Nepal Lube Oil and Raw Hide Collection and Development Corporation were joint venture, second generation companies having majority shares were hold by public enterprises.

Most of the manufacturing enterprises were belonged to import substitution. Jute mills and tannery section of Bansbari Leather and Shoe Factory had some export market. Generally, privatised enterprises were competing with the products imported from India. Harisiddhi Bricks and Tile Factory, Bhaktapur Bricks Factory and Agricultural Tools Factory were facing less competition because of product superiority.

Many enterprises were enjoying some kind of protective market. Bansbari Leather and Shoe Factory had a secured shoe market for the army and police personnel; Nepal Film Development Company had monopoly for documentary and newsreels for government departments; Raw Hide Collection and Development Corporation had monopoly business of collecting raw hides; Nepal Bitumen and Barrel Industry had a secured bitumen market for Nepal Electricity Authority; Tobacco Development Company had secured market for Janakpur Cigarette Factory until 1986; Nepal Foundry Industry had monopoly supply rights in Water Supply and Sewerage Corporation, Nepal Electricity Authority and Nepal Telecommunication Corporation (MOF, 1999).

5.2 Impact of Divestiture Policy

A number of public enterprises have been privatised while some have been liquidated under the divestiture policy. Broadly, the impact of privatised enterprises may be put into two major categories – micro and macro. Unit level performance of privatised enterprises is related with micro impact, while gains at national level is associated with macro impact. The micro impact includes production, sales, productivity, capacity increment, technology development, market development and market diversification. The macro level impact covers burden on public exchequer, ownership distribution, employment, price effects and public participation in divestiture.

5.2.1 Micro Level Impact of Divestiture Policy

5.2.1.1 Production

Privatisation theory believes that the private sector uses resource efficiently and it will help to increase production. Productive resources would be managed in a better way, which ultimately contribute to increase production. Table 5.1 shows the production situation of the privatised enterprises compared with the situation before the privatisation.

Table 5.1
Production of Privatised Enterprises

Enterprise	Unit	Production (before divestiture)	Production (for the year 1996/97)	Increase / Decrease	
				Quantity	Percentage
<u>First Phase (1992)</u>					
Bhrikuti Paper Mills	M.Ton	1500	9124	7624	508.27
Harisiddhi Bricks & Tile Factory	Pieces	17000000	21100000	4100000	24.12
Bansbari Leather & Shoe Factory	Sq.Ft.	190000	947192	757192	398.52
<u>Second Phase (1993-1994)</u>					
Nepal Lube Oil	Lt	505800	971881	466081	92.15
Nepal Bitumin & Barrel Industry					
bitumen	M.Ton	2889	4900	2011	69.60
lube oil	M.Ton	2327	200	-2127	-91.41
emulsion	M.Ton	1	500	499	49900.00
Nepal Film Development Company	Film	8	15	7	87.5
Balaju Textile Industry	Meter	689160	1097175	408015	59.20
<u>Third Phase (1996-1997)</u>					
Nepal Foundry Industry	Kg	161000	170000	9000	5.59
Raghupati Jute Mills	M.Ton	22	23	1	4.55

Source: Department of Auditor-General. 1998.

The comparative production analysis of the privatised enterprises shows that production in these enterprises has been increased. Among nine privatised enterprises, two privatised enterprises have succeeded to increase the production in large scale after divestiture. The production of Bhrikuti Paper Mills was increased by 508.3 percent while the production of Bansbari Leather & Shoe Factory was increased by 398.5 percent.

Four enterprises increased their production modestly. Nepal Lube Oil increased its production by 92.2 percent, Balaju Textiles Industry by 59.2 percent, Nepal Film Development Company by 97.5 percent and Harisiddhi Bricks and Tile Factory by 24.1 percent. Nepal Foundry Industry and Raghupati Jute Mills marginally increased their production by 5.6 percent and 4.55 percent respectively.

5.2.1.2 Sales

Sales is a key indicator to measure the performance of an enterprise. In fact, it has effects in the performance especially on production and profits. Table 5.2 compares the sales situation of privatised enterprise before and after privatisation.

Table 5.2
Sales of Privatised Enterprises

Sales of Privatised Enterprises				
Enterprise	Sales (before privatisation)	Sales (1996/97)	(Rs. in '000)	
			Increase / Decrease Amount	Percentage
<u>First Phase (1992)</u>				
Bhrikuti Paper Mills	76542	340432	263890	344.76
Harisiddhi Bricks & Tile Factory	27827	43093	15266	54.86
Bansbari Leather & Shoe Factory	52044	76090	24046	46.20
<u>Second Phase (1993-1994)</u>				
Nepal Lube Oil	75352	69641	-5711	-7.58
Nepal Bitumin & Barrel Industry	31068	74853	43767	140.79
Nepal Film Development Company	9182	27608	18426	200.67
Balaju Textile Industry	17117	9342	-7775	-45.42
<u>Third Phase (1996-1997)</u>				
Nepal Foundry Industry	5065	4035	-1030	-20.34

Source: Department of Auditor-General, 1998.

Table 5.2 shows that three enterprises, namely Bhrikuti Paper Mills, Nepal Bitumen and Barrel Industry and Nepal Film Development Company, improved their sale situation significantly after privatisation. Their sales increased by 344.76 percent, 140.79 percent

and 200.67 percent respectively. Harisiddhi Bricks and Tile Factory and Bansbari Leather and Shoe Factory moderately improved their sales by 54.86 and 46.20 percent respectively.

On the other hand, the sale of Balaju Textiles Industry, Nepal Foundry Industry and Nepal Lube Oil decreased their sales by 45.42 percent, 20.34 percent and 7.58 percent respectively. It indicates that sales situation of some of privatised enterprises have not been improved.

5.2.1.3 Profit

Profit is the key measuring rod to assess the success of an enterprise. It helps to observe whether the performance is improved or not. Table 5.3 presents the profit situation of the enterprises before and after divestiture.

Table 5.3
Profit Situation of Privatised Enterprises

			(Rs. in '000)	
Enterprise	Profit (before privatisation)	Profit (1996/97)	Increase / Decrease	
			Amount	Percentage
<u>First Phase (1992)</u>				
Bhrikuti Paper Mills	4234	12466	8232	194.43
Harisiddhi Bricks & Tile Factory	1323	N.A.	N.A	N.A
Bansbari Leather & Shoe Factory	764	3000	2236	292.67
<u>Second Phase (1993-1994)</u>				
Nepal Lube Oil	12148	6280	-5868	-48.30
Nepal Bitumin & Barrel	2535	588	-1947	-76.80
Nepal Film Development Company	6521	5845	-678	-10.37
<u>Third Phase (1996-1997)</u>				
Nepal Foundry Industry	-2843	-967	1676	-63.41

Source: Department of Auditor-General. 1998.

The table clearly shows that Bhrikuti Paper Mills and Bansbari Leather and Shoe Factory were successful enterprises to increase profit among the privatised enterprises in the fiscal year 1996/97. Their profits were increased by 194.43 percent and 292.67 percent respectively. The remaining enterprises failed to raise profits, although, with one exception, they continue to make a profit. Two privatised enterprises, Nepal Lube Oil and Nepal Foundry Industry, failed to increase their sales which was the main cause for decreased profits. In fact, most of the enterprises, in general, have been struggling to increase profits after the privatisation.

5.2.1.4 Employee Productivity

Employee productivity is defined as average output per labour (CRPS, 1995:30). It is generally believed that the employee productivity would be high in the private sector enterprises as compared to the public sector enterprise. Table 5.4 illustrates the productivity situation of some privatised enterprises.

Table 5.4
Employee Productivity

Enterprise	Unit	Before Divestiture	After Divestiture	Remarks
First Phase (1992)				
Bhrikuti Paper Mills	M. ton	9.43	11.66	Increased
Harisiddhi Bricks & Tile Factory	Pieces	29,000	32,000	Increased
Second Phase (1993-1994)				
Nepal Bitumin & Barrel Industry				
Bitumen	M. ton	52	37	Decreased
Lube Oil	M. ton	248	251	Increased
Balaju Textile Industry	Meters	4150	2200	Decreased

Source: CRPS, 1995.

The table 5.4 shows that out of the four enterprises, for which information was available, in two enterprises, namely Bhrikuti Paper Mills and Harisiddhi Bricks and Tile Factory, productivity was increased. In the case of Balaju Textiles Industry, the productivity was decreased. On the other hand, Nepal Bitumen and Barrel Industry had a mixed result. It indicates that on an average, the productivity of privatised enterprises does not show an increasing trend.

5.2.1.5 Capacity, Technology, Market Expansion and Product Diversification

Competitive capability of an enterprise depends upon various elements. Capacity utilisation, technological advancement, market expansion and product diversification are some important elements. Table 5.5 illustrates the relationship between the strategy towards expansion and development of organisation.

Most of the privatised enterprises have increased their capacities. Out of ten enterprises, six enterprises have increased their capacities. On the other hand, out of ten privatised

enterprises, seven enterprises are involved in technological development. Balaju Textile Industry has not launched the technological development programmes. As a result sales have declined, prices increased and overall performance remained unsatisfactory. Enterprises such as Raghupati Jute Mills, Agricultural Tools Factory and Balaju Textiles Industry are not involved in the market expansion. In fact, their markets are limited to a certain group of consumers or a certain geographic area, so these enterprises are not able to expand market area.

Table 5.5
Competitive Capability of Privatised Enterprises

Enterprise	Capacity Increment	Technology Development	Market Development	Product Diversification
First Phase (1992)				
Bhrikuti Paper Mills	Yes	Yes	Yes	Yes
Harisiddhi Bricks & Tile	Yes	Yes	Yes	Yes
Bansbari Leather & Shoe	Yes	No	No	No
Second Phase (1993-1994)				
Nepal Lube Oil	No	Yes	Yes	Yes
Nepal Bitumin & Barrel	No	Yes	Yes	Yes
Nepal Film Development	Yes	Yes	Yes	Yes
Balaju Textile Industry	No	No	No	No
Third Phase (1996-1997)				
Nepal Foundry Industry	No	Yes	Yes	No
Raghupati Jute Mills	Yes	Yes	No	Yes
Agricultural Tools Factory	Yes	No	No	No

Source: Department of Auditor-General .1998.

Product diversification is associated with market sales and production. Enterprises like Balaju Textiles Industry and Nepal Foundry Industry could not diversify their products. So, these enterprises are not only facing the problems of market, sales and production but also making financial losses.

5.2.1.6 Pattern of Micro Impact

It is an open secret that the public enterprises in Nepal are being handed to the private sector because of their chronic ill health and non-fulfilment of pre-determined objectives. After divestiture of enterprises, the overall performance of privatised enterprise has a mixed trend. Table 5.6 presents the different aspects of privatised enterprises.

From the production point of view, performance of privatised enterprises is in a very good situation. Almost all (88.9 percent) privatised enterprises increased their production. Likewise, 62.5 percent of privatised enterprise did well to increase their sales. On the other hand, 67.7 percent of privatised enterprises failed to increase their profit while only 33.3 percent enterprises succeeded to increase profit. However, most of the privatised enterprises are not making loss.

Capacity growth has presented a mixed trend. Technological advancement shows the encouraging trend. However, technological advancement of 30 percent of privatised enterprises has remained static. Market expansion and product diversifications have also presented a mixed trend. In addition, 60 percent privatised enterprises have achieved success both at market expansion and product diversification levels whereas 40 percent privatised enterprises could not show any positive impact.

Table 5.6
Overall Performance of Selected Privatised Enterprises

Indicators	N*	Increase (%)	Decrease (%)	No effects (%)	Mix (%)	Remarks*
Production	9	88.9	-	-	11.1	Very Good
Sales	8	62.5	37.5	-	-	Satisfactory
Profit	6	33.3	67.7	-	-	Poor
Productivity	4	50.0	25.0	-	25.0	Poor
Capacity Growth	10	60.0	-	40.0	-	Fair
Technological Upgrade	10	70.0	-	30.0	-	Satisfactory
Market expansion	10	60.0	-	40.0	-	Fair
Product Diversification	10	60.0	-	40.0	-	Fair

Source: based on table 5.1 to 5.5

In fact, capacity increment, technology development, market expansion, product diversification are the key elements for the success of any enterprises. The table shows that those enterprises that have utilised and adopted these elements are seen as the most successful enterprises. Bhrikuti Paper Mills is a successful privatised enterprise, which is involved in capacity increment, technological upgradation, market expansion and diversification. Hence, it succeeded to increase production, sale, profit and employment. On the other hand, some unprofitable enterprises have not launched the technological development. As a result sales

* It shows the number of privatised enterprises whose data has been analysed.

* Scale of comparison is presented as follows: Very Good for more than 80 percent; Good for 71 to 80 percent; Satisfactory for 61 to 70 percent; Fair for 51 to 60 percent; and Poor for 50 and below than 50 percent.

have declined, prices increased, profitability lowered and overall performance remained poor or fair.

On the other hand, due to failure of the lease obligation by the management of Bhaktapur Bricks Factory, the lease agreement has been terminated and the enterprise has been taken over by government. Likewise, government closed the Biratnagar Jute Mills because of breakdown of terms and conditions of contract by management group. In addition, two privatised enterprises have been closed down. Dispute among owners is the main cause for the closure of Raw Hide Collection and Development Corporation and Agricultural Tools Factory (MOF, 1999).

5.2.2 Macro Level Impact of Divestiture Policy

5.2.2.1 Financial Subsidies

Public enterprises are considered to be a drain on resources because they rely more on the government budget. Subsidies to public enterprises are provided in the form of operating subsidy, transport subsidy and capital subsidy. Table 5.7 presents the government subsidy to public enterprises.

Table 5.7
Government Subsidy to Public Enterprises

						(Rs in million)
Year	Operating/Transport Subsidy	Capital Subsidy	Total	Annual Growth		Inflation (Percent)
				Subsidy	Budget	
Before Divestiture						
1988/89	36.2	410.5	446.7			
1989/90	18.1	446.8	464.9	6.67	13.63	11.00
1990/91	43.2	724.0	767.2			
1991/92	170.0	372.2	542.2			
After Divestiture						
1994/95	571.4	77.5	648.9			
1995/96	726.0	197.0	923.0	17.95	12.84	7.00
1996/97	713.6	180.0	893.6			
1997/98	988.0	76.9	1064.9			

Source: Ministry of Finance, 2000. & World Bank. 2000.

One of the objectives of privatisation is to reduce financial and administrative burden of government in managing the public enterprises. Table 5.7 clearly shows that annual growth of

subsidy has been increasing while annual growth of budget and inflation is decreasing after the implementation of divestiture policy. Annual growth of subsidy was less before implementation of divestiture policy, despite of high inflation and more annual growth of budget.

After divestiture of some enterprises, the volume of government subsidy to public enterprises has not decreased. After implementation of divestiture policy, amount operating and transport subsidy has increased. However, volume of capital subsidy has started to decline.

5.2.2.2 Employment

It is assumed that the active participation of private sector in economic activities would generate employment opportunities. In this context, employment is a major indicator to assess the impact of divestiture policy. Employment effect of privatisation is presented below.

Table 5.8
Employment Effects of Privatisation

Enterprise	Before	After	Difference		Remarks
	Privatisation	Privatisation	Number	Percentage	
<u>First Phase (1992)</u>					
Bhrikuti Paper Mills	1321	1800	479	36.26	Increase
Harisiddhi Bricks & Tile Factory	595	500	-95	-15.97	Decrease
Bansbari Leather & Shoe Factory	545	83	-462	-84.77	Decrease
<u>Second Phase (1993-1994)</u>					
Nepal Lube Oil	101	93	-8	-7.92	Decrease
Nepal Bitumin & Barrel Industry	58	54	-4	-6.90	Decrease
Raw Hide Collection & Dev. Corp.	564	0	-564	-100.00	Closed
Nepal Film Development Company	99	54	-45	-45.45	Decrease
Balaju Textile Industry	165	101	-64	-38.79	Decrease
<u>Third Phase (1996-1997)</u>					
Nepal Foundry Industry	65	20	-45	-69.23	Decrease
Raghupati Jute Mills	1114	1446	332	29.80	Increase
Agricultural Tool Factory	287	0	-287	100.00	Closed
Total	4914	4151	-763	-15.63	Decrease

Sources: Department of Auditor-General.1998. & CRPS, 1995

Out of eleven enterprises, two enterprises, Bhrikuti Paper Mills and Raghupati Jute Mills, succeeded in generating employment. In seven enterprises, employment decreased while two enterprises were closed. Before divestiture, 4914 employees were engaged in 11 enterprises. After divestiture, the number came down to 4151, a fall of 15 percent.

A trade union leader argued that a policy of workers retrenchment in privatised enterprises had been implemented to increase efficiency. This policy directly undermines job guarantee rights of the workers and, at the same time, makes the job of the workers highly insecure (Rimal, 1996:99). Further, he argued that the main cause of profit in privatised enterprise is curtailment of various facilities to the workers (ibid:93). It indicates that divestiture of public enterprises has curtailed employment opportunities and facilities for workers.

5.2.2.3 Price Effects

Some enterprises increased the price of their products. Indeed, rising price is one of the negative effects of divestiture. However, there could be a number of factors that influenced the price rise, for example, subsidiaries inflationary pressure and rise in prices of inputs etc. Table 5.9 illustrates the changes the prices of privatised enterprises.

Table 5.9
Changes in Prices

Enterprise	Price unit	Before Divestiture	After Divestiture	Price increase ^{a)}	Inflation ^{b)}	Actual Increase ^{c)}
First Phase (1992)						
Harisiddhi Bricks & Tile Factory						
*Bricks	Rs per '000	1600	2400	14.47		6.4
*Roof tiles	Rs per '000	4140	10000	34.17		26.1
*Floor tiles	Rs per '000	1600	3500	29.81	8	21.8
Second Phase (1993-94)						
Balaju Textile Industry	Rs per meter	27.60	41.90	14.93		6.9
Raw Hide Collection & Development Corp.	Rs per piece of hide	250	650	37.50		29.5

Sources: CRPS. 1995 & World Bank. 2000.

In case of Harisiddhi Bricks and Tile Factory, the actual price of bricks, roof tiles and floor tiles increased by 6.4, 26.1 and 21.8 percent respectively after divestiture. Similarly, Balaju Textiles Industry increased 6.9 percent in price of its product. In addition, Raw Hide Collection and Development Corporation raised the prices of raw hide. It shows that

^{a)} It refers the annual price increase in percentage, which is calculated from 1992 to 1995.

^{b)} It shows the average inflation of Nepal in the period 1992-1995.

^{c)} It shows the actual increase of price (in percentage) which is derived from the subtraction of inflation value from the price increase (in percentage).

these enterprises increased price of their product after the divestiture. It may be result of the end of government control and free play of demand and supply forces in the market.

5.2.2.4 Ownership Distribution

It is believed that privatisation can contribute to increase ownership of general people in enterprises by purchasing share. Privatisation is people's capitalism, according to David Heald, which legitimate the transfer of public assets to private hands (Heald, 1990:10). One of the objectives of privatisation in Nepal is to involve participation of general public in the management of public enterprises. The structure of equity ownership in the privatised enterprise is shown in table 5.10.

Table 5.10
Equity Ownership of General Public in Privatised Enterprises

Enterprise	Share Ownership		
	Management	Employees	General Public
First Phase (1992)			
Bhrikuti Paper Mills	70	5	25
Harisiddhi Bricks & Tile Factory	72	5	23
Bansbari Leather & Shoe Factory	70	5	20
Second Phase (1993-1994)			
Nepal Film Development Company	51	5	44
Balaju Textile Industry	70	5	25
Raw Hide Collection & Development Corp.	100	-	-
Nepal Bitumin & Barrel Industry	65	5	30
Nepal Lube Oil	40	5	55 [#]
Third Phase (1996-1997)			
Nepal Foundry Industry	51	5	44
Raghupati Jute Mills	65	5	30
Nepal Bank Ltd	-	5	56 [*]
Agricultural Tools Factory	65	5	30

Source: Ministry of Finance, 1999

[#] Government could not sell 55 percent of shares of this enterprise. So, still government has been holding these shares since 1994.

^{*} Government owns 39 percent of shares.

The table shows the management has held the majority of shares. The general public has owned between 20 to 56 percent of the shares in the privatised enterprises. Generally employees are found owning five percent shares. In fact, general public can not put their voice in the management as a shareholder. Only in Nepal Bank Limited does the public have a majority share. The equity share in Bansbari Leather and Shoe Factory has been 70 percent, 20 percent and 5 percent by the management, the public and employees respectively.

In two enterprises, Raghupati Jute Mills and Nepal Bitumen and Barrel Industry, the equities have been shared by management, employees and public with a ratio of 65 percent, 5 percent and 30 percent respectively. In some of the enterprises, management and public only have shared the equity ownership. Some of the enterprises have been transferred to the private sector on management contract or on lease retaining the ownership with the government, for example, Biratnagar Jute Mills and Bhaktapur Bricks Factory.

On the other hand, Harisiddhi Bricks and Tile Factory is the first and only privatised enterprise that organised a shareholder's meeting in April 2000 after eight years of privatisation. In this situation, it is difficult for general people to participate in management. In fact, such circumstances will not motivate the general public to buy shares of privatised enterprise.

5.2.2.5 Participation of Private Sector and General Public in Divestiture

In the divestiture process, the private sector has not demonstrated its willingness to buy public enterprises nor has general public demonstrated its interest to buy shares of privatised enterprises. However, one of the objectives of privatisation policy is to involve general public and private sector in the management of public enterprises. Table 4.4 shows that few bidders participated in most of the divestiture process. To some extent, Bhrikuti Paper Mills and Nepal Lube Oil were sold in a competitive bidding process.

Every citizen wants transparency in privatisation process. In fact, it will ultimately increase the participation of private sector and trust upon government activities. However, only 40 percent business people assessed the decisions of privatisation as transparent (Business Age, 2000). It clearly illustrates that a majority of business people are not satisfied with the process of divestiture. It is one of the major causes that discourage the private sector from participating in the bidding process. In the first phase of divestiture process, there were some bidders. In the second and third phase, except in Nepal Lube oil, there were very few bidders. Even in three enterprises, there was only one bidder.

Table 5.11
Attractiveness of Divestiture Policy to Private Sector and General Public

Enterprise	No. of bidders	Share Owned by Government
First Phase (1992)		
Bhrikuti Paper Mills	8	---
Harisiddhi Bricks & Tile Factory	5	---
Bansbari Leather & Shoe Factory	4	---
Second Phase (1993-1994)		
Nepal Film Development Company	2	5 %
Balaju Textile Industry ⁺	2	---
Raw Hide Collection & Development Corporation	1	---
Nepal Barrel and Bitumen Industry [*]	3	---
Nepal Lube Oil	12	55 %
Third Phase (1996-1997)		
Nepal Foundry Industry	2	49 %
Raghupati Jute Mills	1	34 %
Birtanagar Jute Mills	1	---
Agricultural Tools Factory	3	35 %
Bhaktapur Bricks Factory	3	--

Source: Department of Auditor General, 2000

The government made provisions to sell some percentage of the shares of privatised enterprises to the general public, but the general response has not been enthusiastic. The government has kept shares of some privatised enterprises, which were allocated to general people. Government was unable to sell 55 percent shares of Nepal Lube Oil. In addition, the management of Balaju Textile Industry and Nepal Bitumen and Barrel Industry bought the share that has been allocated to the general public.

5.2.2.6 Patterns of Macro Impact

The prices of most of the products manufactured by privatised units increased. The actual increase in prices ranged from 6.4 percent to 29.5 percent. Privatisation has negative impact on employment. Four-fifths of privatised enterprises have reduced the number of employees, but 18.2 percent of privatised enterprises created more jobs. On the other hand, participation of private sector and general public in divestiture programme has not been enthusiastic. Even

⁺ 30 percent shares were allocated to public. However, public did not buy it. So, management of enterprise bought itself these shares.

^{*} Management of enterprise bought 35 percent of shares, which were allocated to general public.

after privatising 25 percent of public enterprises, the quantum of total subsidies has increased. After the implementation of privatisation policy, operating subsidies have increased but capital subsidies have reduced.

Privatisation policy has not reduced budgetary burden of the government. Nor has it improved the share of enterprise ownership substantially, attracted massive private investment or generated employment and stabilised prices. From the review of the impact evaluation, it is time to reform divestiture policy to increase its efficiency to achieve its objectives.

5.3 Summary

Overall production has increased. In addition, sales have accelerated. But, most of privatised enterprises were failed to increase their profit. Capacity utilisation has presented a mixed trend. Technological improvement is encouraging. Market expansion and product diversification has also presented a mixed trend. The prices of product manufactured by privatised units increased. Even after privatisation of 25 percent of public enterprises the volume of total subsidies has increased. In fact, privatisation should not be considered as the best medicine that can cure sick privatised units all of a sudden. It may take time to bring these enterprises on the right track of performance.

CHAPTER SIX

SUMMARY AND CONCLUSION

6.1 Summary of Research Findings

Privatisation is expected to increase performance efficiency, financial efficiency, and productivity. This study has shown that the overall performance of privatised enterprises is mixed. From the production point of view, the majority of privatised enterprises did well to improve their production situation. Likewise, 62.5 percent of privatised enterprises increased their sales. However, only one third of privatised enterprises increased their profits. The productivity of privatised enterprises does not show an improving trend. In addition, 25 percent of privatised enterprises were closed down due to lack of managerial capability of private sector.

The prices of most of the products manufactured by the privatised enterprises have increased. Privatisation has had a negative impact on employment. Out of eleven enterprises, the number of employees has reduced in nine enterprises and increased in only two cases. Even after privatisation of a quarter of all public enterprises in Nepal, the quantum of total subsidies for public enterprises has increased. However, capital subsidy to public enterprises has been decreasing after the implementation of divestiture policy. On the other hand, participation of private sector and general public in divestiture programme is not stimulating.

6.2 Conclusion

Privatisation is too often a process rather than a pragmatic solution. In fact, it takes time to see the exact outcome of divestiture policy. However, production, sales, technological improvement aspect of privatised enterprises has satisfactorily improved. In addition, they are doing well in capacity growth and production diversification area. These efforts will help to improve the performance of privatised enterprises in future.

The privatisation process in Nepal is not an exception to these problems. The economy is in an early stage of development with several structural problems. Major constraints

include the smallness of its private sector, a shortage of managerial capability, narrow domestic markets and an open border with the large economies of India and China. These have made implementation of divestiture policy difficult.

The business community, which always favours privatisation, is not satisfied with the process of privatisation, especially in transparency. Furthermore, there has been a lack of public support for the divestiture programme because of misinformation resulting from the absence of transparency in the process of divestiture.

One of the objectives of divestiture programme is to reduce financial burden. In fact, there is a positive fiscal effect of privatisation in some extent. The government is not giving subsidy to 16 privatised enterprises and it has collected revenue by selling public enterprises. In addition, it has relieved the government to manage these enterprises. Likewise, divestiture policy has stopped the creation of new public enterprises. This is an important contribution to the economic policy of Nepal.

6.2 Suggestions of Alternatives

Privatisation generally involves the transfer of ownership and/or management to the private sector. The private sector would be very interested to look upon the credibility of the enterprise. Private sector prefers to buy profit-making enterprises than loss making ones. In fact, in the Nepalese context, divestiture of public enterprises is supply oriented than demand oriented. In most of cases, few private sectors participated in bidding process. Thus, public enterprises need to be restructured prior to the divestiture process. In these circumstances, political commitment is the most essential factor to reform public enterprises. Indeed, this would help in attracting the private sector for investment and in attaining operational efficiency of the privatised units.

In order to increase the efficiency of public enterprises, the NPM approach can be applied in some public enterprises on an experimental basis. The government can provide necessary policy guidelines for management of enterprises to achieve specific objectives. In this context, government should motivate the manager of enterprises to apply good

management practices of private sector in public enterprises. Furthermore, the government can increase greater competition among public enterprises of the same sector/industry. For example, managers can be appointed in different sugar factories or cement factories to achieve some goals in fixed time periods providing freedom to manage the enterprises. After completing fixed time, the government can evaluate the changes and compare its performance. In this way, good management practices of one enterprise can be applied to other enterprises.

Divestiture procedures are being criticised mainly due to the lack of adequate transparency. Hence, before privatising a unit, appropriate transparency must be contained in such policy and procedures. Government should use appropriate media, such as radio, television, and newspaper to disseminate facts about divestiture. Transparency in the divestiture process needs to extend to the announcement of and justification for decisions on selection of enterprises, modality, selection of investor, price, treatment of employees, treatment of liability divestiture proceeds and status reports on individual transactions.

This study shows that consumers and employees have been the main losers from privatisation. Prices of products manufactured by the privatised units have increased. In addition, numbers of employees have lost their jobs. In this situation, government should create an environment to increase healthy competition among producers of goods and services. Furthermore, regulatory mechanisms should be strong to control the price and promote competition. In fact, competition could directly remove the monopoly behaviour of any firm and deliver goods and service at the lowest economic cost. In addition, government can provide training to develop new skills for job losers of enterprises. In fact, this opportunity will ultimately help to get new job.

Government can select public enterprises to privatise after evaluating its performance. Then, it is essential to construct national consensus through seminars, workshops and public debates in favour privatisation of the public enterprise.

The role of private sector in development is still at an early stage in Nepal. In this context, the process of divestiture should be adopted gradually by following the principles of learning by

doing. The process of divestiture should not be target based, such as 30 public enterprises in the Ninth Plan period; rather, it should be need based. The divestiture policy should be on a selective basis rather than wholesale divestiture.

The government adopted the modalities of asset sale, share sale, management contract, lease and liquidation. A producer's consortium model was followed in the case Raw Hide Collection and Development Corporation which turned out to fail due to dispute among nine owners. Leasing out and management contract were implemented in Bhaktapur Bricks Factory and Biratnagar Jute Mills respectively, but they were not successful to run enterprises. There are various modes of privatisation. All the modes may not be effective for all the public enterprises to be privatised. So, the mode of privatisation should be based on the nature of specific enterprises.

The responsibility of government in the process of privatisation should not be simply transfer of ownership/management of enterprises to the private sector, but also should bear the responsibility of making the enterprise function well in accordance with privatisation conditionalities. The government should monitor and evaluate the privatisation programme frequently. Effective monitoring and evaluation could facilitate the government in reviewing the effectiveness of the policy. In addition, it provides an opportunity to adopt corrective measures for a future divestiture programme.

The key factor determining the efficiency of an enterprise is not whether it is publicly or privately owned, but how it is managed. In these circumstances, divestiture should be encouraged through corporate culture, better professionalism, efficiency, and people's participation.

A dualistic economy exists in Nepal. The urban economy will be influenced by the privatisation policy that can create favourable background for the participation of private sector. On the other hand, the rural economy tends to be improved through the public enterprise policy. Rural poor people can be protected by the continuity of public enterprise approach. In these circumstances, a proper balance between the public and private sector can be seen as an ideal option for the socio-economic development of the country.

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Composition of Privatisation Committee

a) Minister or State Minister for Finance	Chair
b) Chairman, Finance Committee (House of Representatives)	Member
c) Two Members of Parliament nominated by government	Member
d) Member, National Planning Commission	Member
e) Secretary, Ministry of Finance	Member
f) Secretary, Ministry of Law, Justice and Parliamentary Affairs	Member
g) Secretary, Ministry of Labour	Member
h) Secretary, Ministry concerned with the enterprise being privatised	Member
i) President, Federation of Nepalese Chamber of Commerce and Industry	Member
j) Joint-Secretary, Ministry of Finance (Corporation Co-ordination Division)	Member-Secretary

In addition, the act requires the PC to appoint a team of experts or, if necessary, a joint team of national and foreign experts for the evaluation of the enterprise. The privatisation cell, established within the Ministry of Finance, has been set up as the team of experts and works as the secretariat to the privatisation committee. The privatisation cell receives orders and directives from government and carries out the privatisation process.

Powers, Functions and Duties of Privatisation Committee

- a) to recommend programmes and priorities of privatisation to the government, in view of suggestions contained in the Finance Committee Report (of the House of Representatives);
- b) to conduct study or research in order to formulate privatisation programmes;
- c) to require evaluation of the enterprise and to recommend the government on the process of privatisation;
- d) to remove hindrances faced in privatisation programme and maintain coordination;
- e) to follow up the decisions and agreements relating to privatisation and cause to do so;
- f) to constitute sub-committees, as may be necessary, in respect of privatisation; and
- g) to perform or require to be performed other works, if necessary, in respect of privatisation.

