

The Economic Transformation from Public to Private Sector

Adopting a Privatization Policy in Nepal

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1. Introduction

The structural weakness of the European and American market economies, which were cruelly exposed during the economic recession of the 1930s, led to a rethinking of economic policies even in countries surrounded by ardent protagonists of the concept of free markets. A feeling that government was required to guide the market cropped up during this decade. This led to the establishment of a number of State Owned Enterprises (SOE) in countries adopting various new ideologies. Some with diametrically opposite ideologies have at the same time embraced the policy of involving the state in the business of providing goods and services to both a national as well as an international consumer base. However, this system too was problematic. In fact, the problems presented by the public sector's involvement in business became painfully evident during the 60s when the foundations of even economically powerful governments like the United Kingdom started shaking due to the enormous losses created by the SOEs.

The decade of 70s witnessed the role of a free, open and liberal approach in transforming the face of the European and American economies. The example set by the Asian Tigers had proven the role of the state in managing businesses should be within the private sector. Globalization, liberalization and privatization became new buzzwords in Europe and America, and the paradigm shift in the economic policies of the government became evidently clear. With the beginning of the new millennium, the world economy has entered into a new situation and new way of thinking. Due to the collapse of the Soviet Union, many countries are seriously rethinking socialism. The socialist and planned economic countries have gradually changed their policies to open or market based economic strategies. Therefore, the thinking of liberal economic policy emerged in the

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70s. The economic models based on the intervention role of the state were replaced by market-oriented policies and development strategies.

In Nepal where the private sectors did not develop to the same extent, the prevailing economic dogma of state intervention and the availability of foreign aid (in the form of turn-key projects) have heavily contributed to state ownership of businesses and industries. From the 60s to the early 80s, the number of public enterprises in Nepal increased. During this period, commercial banks were established and the daily consumption of goods and use of agricultural tools increased. By the beginning of the 80s, the state-owned insurance company covered 61 public enterprises. The share of domestic investment given to public enterprises was relatively large - about 43 percent of GDP (Manandhar [29]) and it nearly doubled the amount invested by the government in public enterprises in the 70s. The majority of manufacturing public enterprises are still dominated by the government, and these enterprises are absorbing a large unskilled labour force. Influenced by success stories involving the transfer of SOEs to private companies in developing countries, the Nepali Government has realised that by adopting privatization policy they can improve the performance of enterprises and help relieve some of the financial burdens. Some of the measures taken by the government over the past 12 years include financial liberalization, external sector liberalization and the removal of the restriction on private sectors and the rationalization of tariffs.

1.1 History of Privatization

The first appearance of privatization was in the Adenauer Government in the Republic of Germany in 1961, when that government sold a majority of stakes in Volkswagen through a public offering mainly to small investors. However, it is widely recognized that the formal procedure of privatization began in the U.K. in 1978. In the U.K., the first company to become privatized was the previously state-owned enterprise, British Petroleum (BP). The problems of SOEs were not new. Adam Smith had advocated in his popular book *Wealth of Nations* (1776): "When crown land has become private property, they would, in the course of a few years, become well improved and well cultivated". It was not difficult to see why industries worldwide were failing to live up to the high ideals set by their founders. Managers cannot manage properly if their founders determine all their decisions. How can a company hope to be profitable if bureaucrats and civil servants whose political concerns take priority over commercial interests determine all their decisions? Likewise, a crucial stimulus is taken away if managers and the workforce know that, in the end, their financial position will always be underwritten by the state.

The largest scale privatization program was accomplished in the Great Britain of Margaret Thatcher's conservative government. In 1979, Thatcher's government started a privatization program by selling British Petroleum Enterprises (Ramanadham [38]). By the time privatization became an active proposition, most of the nationalized industries were profitable, and had adopted what could be claimed to be private sector models of behaviour (Aktan [1]). Privatization has become a central feature of economic policies in a variety of countries in the developed and underdeveloped world in both the capitalist and socialist states. Broadly defined, privatization embraces denationalization and selling of state-owned assets, liberalization, and comparative tendering, together with the introduction of private ownership and market arrangement in socialist states (i.e., Eastern Europe and Russia). Public sector assets have been sold to the private sector through share issue, employee or management buy-out, and direct purchase. Such sales to the private sector have involved public utilities, manufacturing industry and services. *The Nepalese Privatization Act 2050* (1991) has defined the concept of privatization as the process of involving the private sector in the management of enterprises, the selling of or leasing of enterprises, or an act to infuse participation by any means, either wholly or partly, of private sector or of the employees or workers, or of all desirous groups.

2. Why is privatization necessary?

The main argument for why privatization of public enterprises is needed is to improve poor financial performance. Privatization today is being driven by a pragmatic reaction to compensate for three decades of poor financial conditions and mismanagement of SOEs. Private ownership is thus favoured on the basis that returns to capital are lower among state-owned enterprises and that they generally have a poor reputation for innovation, diversification and quality of goods and services (Cook and Uchida [4]). Vining and Anthony ([43], 1992) argued that "While the introduction of product market competition can improve performance, there is strong empirical evidence that ownership matters and matters a lot". But privatization is neither a necessary nor sufficient condition for improving enterprise performance. Business performance can also be improved through reforms of management in SOEs, deregulation and liberalization. The developing socialist countries of the 60s were forced to privatize by the International Monetary Fund (IMF) and World Bank. The SOEs lacked budget, or had a severely restricted budget and suffered from these financial restraints.

Privatization is an instrument to attract foreign direct investment (FDI), and it also contributes directly to overall FDI flows through the sale of assets to foreign investors. Privatization shows an increased openness towards private business and an increased willingness of the government to support the private sector. Privatization is a very important element in the FDI decision. The anticipation of privatization-related FDI inflows could be a significant reason for encouraging divestures by a government facing financial constraints and underinvestment in key infrastructure services (Sader [39]). A competitive environment needs to be created for a successful privatization program to increase its favourable effects. The absence of a competitive environment could only mean that the privatization could change firm ownership without changing firm behaviour.

2.1 Advantages and Disadvantages of Privatization

Privatization has its supporters and opponents. Privatization supporters contend that privatization encourages cost savings and introduces foreign capital and a rise in competitive service. The opposition argues that privatization leads to a cost increase and an increase in unemployment.

From Table 1 we can argue that privatization introduces healthy competition, provides high quality of service, reduces unnecessary government expenditure, and improves business attitudes in many aspects of the SOEs. However, it also makes the case that privatization decreases job security and increases social conflict. Another disadvantage of privatization is that working hours may be increased as the government has no longer accountability for such matters.

Table 1. Argument for and against privatization

Arguments for Privatization	Arguments against Privatization
1. Governments can save money. 2. High quality of service 3. Innovative approach to technology 4. Dissolves unnecessary government services and monopolies. 5. Slows the growth of government. 6. Competition between government and private provider	1. Does not save the taxpayer money. 2. Leads to corruption. 3. Diminishes government accountability. 4. Job losses 5. Government may lose their power. 6. Conflict between trade union and investors

2.2 Methods of Privatization

Many countries have adopted the sale of assets method. Some of these countries used the voucher method (i.e., Russia). Some tried contracting out or the franchise method (i.e., China). Below are outlined different methods of privatization.

Contracting out: In this method the government contracts out to both profit and non-profit organizations for delivery of goods and services.

Assets sales: The government sells SOEs to private companies. After selling the properties, the government has no responsibility for the enterprise anymore. Most of the least-developed governments adopted this kind of privatization method.

Deregulation: Under this system, the government stops their regulation in some enterprises or in some services. In some of the countries, the government has a monopoly over oil, steel, natural gas and other natural resources. The private sectors could not compete in these industries. After privatization, the governments have competition in these sectors.

Franchising: In this method the government gives special authority to private sectors to produce a particular service or material. The government contracts either one enterprise or many other enterprises for this facility. The franchising method is especially common for delivery of toll goods (i.e., highway roads, bridges and rope ways) which have natural monopoly characteristics.

Grants and subsidies: In this system the government provides loan or cash subsidies to the private sector for increasing production and services. Sometimes the government may give tax subsidies for certain goods for a particular season or time. The government gives a special grant to private businesses to encourage them to improve efficiency and create new jobs.

Vouchers: In this method the state allows eligible clients to purchase services available in the open market from private providers. As with contracting, the government pays for the services. This system is implemented, in general, with food stamps, tuition, Medicare or child-care, housing and transport areas. Russia's privatization policy is a major example.

Management contract: Sometimes governments give management contracts to other private sectors for certain times. In developing countries, the government has given commercial banks management to foreign banking enterprises to improve their financial situation.

Build-Operate-Transfer system (BOT): BOT is a new approach of privatization in developing countries. This method is very popular in some developing countries. By this system, the developing countries are successful in attracting foreign capital. Foreign private capital, particularly in the form of direct investment, plays an important role in economic development of developing countries.

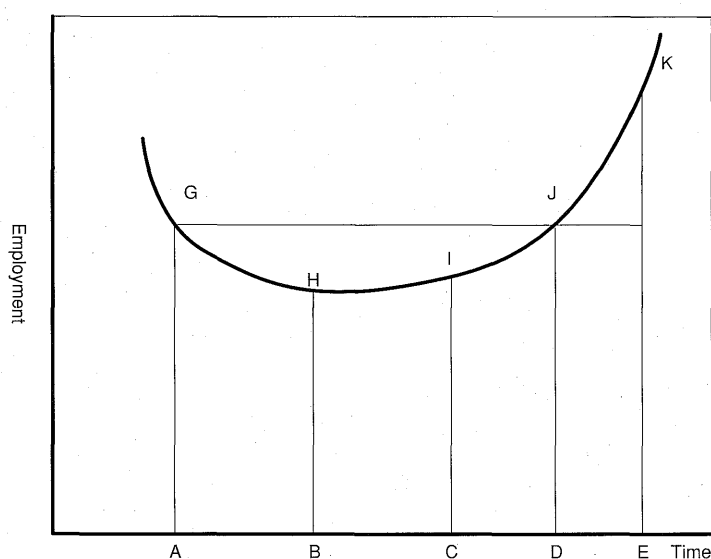
2.3 Privatization and Labour

Much of the literature on privatization has promoted greater allocative and productive efficiency, and reduced distortions resulting from excessive subsidies and taxation (Sheshinski and Lopez [42]). However, privatization can have an adverse effect on employment in the short term. It can cut many necessary benefits of labour, subsidies, redundancies on labour force, and reduce wages level and employed part-time and contract labour for saving of labour benefits like pension, bonus and financial allowance for health, children education and so on. The labourers fear that privatization will make employment fall. First, in some instances, the adverse impact on employment may seem small, as layoffs may have been made prior to restructuring. At the same time, the new ownership and management are willing to clear evil environment and improve the performance of labour productivity. The new owner tries to expand enterprises at a full capacity of production. The result of much research shows that public enterprises were not expanded or used to full capacity. Hence, the job opportunities may be increased for meeting the full capacity of enterprises. It can be said that employment would be increased. The analysis should be defined as having three phases: a pre-privatization period, a privatization period and a post-privatization period. The level of employment in the firm could follow a U-curve (Gupta and Schiller [12], 1999) (See Figure 1). In this case, privatized public enterprises first reduce employment in the short term. The line AG is the employment in the pre-privatization period. The new management may start reducing excess labour or may make a favourable situation for new enterprises for their own interests. Then, after recovering their own condition, they start to run the enterprises at full capacity. The starting enterprises take over employment at conditions before privatization. The length DJ is the same as the length AG, and here the employment is the same as before. If the firm expands to full capacity, or if the firm conquers competition with other rival enterprises, it will increase its employment and join the line EK.

The developing countries have launched ambitious privatizations program to improve the efficiency of SOEs, free up resources for social services and mobilize capital for

expansion and modernization. A number of countries have successfully privatized their infrastructure enterprises that accounted for the bulk of the financial and economic burden. As a result, state enterprises still play an important role in developing economies. In a sample of 40 developing countries, state enterprises account for 11% of GDP, 20% of investment and 5% of modern sector employment. Among the low-income countries in the sample these shares are even higher: state enterprises provide 14% of GDP, 27% of investment and 18% of modern sectors employment (World Bank [44]).

Figure 1. Privatization and Employment



Source: Gupta et.al. [12], 1999.

The privatization of large enterprises and infrastructure is crucially important in developing countries. The major reason why privatization has proceeded slowly and why the potential economy-wide gains from large-scale privatization have been delayed results from concern about the effect that privatization has on labour. Many observers fear that privatization will cause major job losses as new owners of privatized firms shed excess labour to improve efficiency, and as divesting governments cut the workforce to prepare for privatization by often threatening or taking actions to block or delay reforms. While many laid-off workers may suffer only temporary losses and can recover if they move quickly to expanding sectors, others will suffer major losses or are forced into lower paying jobs. In fact, the lack of information on what has happened to workers in the privatization

process and on the mechanisms available for minimizing the political and social cost has invoked fear and concerns for workers and governments, and delayed privatization has resulted.

2.4 Evidence in Nepal

In a developing country like Nepal, the SOEs are the main job provider for unemployed and unskilled people. In most of the developing country's state-owned companies, employees enjoy more benefits and a higher level of wages than those in private firms. On the other hand, these SOEs have low productivity, low efficiency and excessive labour cost, which, in turn, have contributed to inefficiencies and financial losses. In many of the developing countries trade unions are afraid of privatization because the government would not succeed in improving the efficiency and profit without a large reduction of the labour force and other major restructuring. In fact, privatization in developing countries seems to have had adverse results for labour forces. But in some cases expansions of enterprises have resulted in new job creation, productivity improvement and have provided better services to the public and more benefits for the labour force.

The policy paper on privatization of public enterprises adopted by the Nepali Government in 1991 envisaged bringing about operational efficiency that would result in higher productivity in the privatized enterprises. In the process, a certain amount of restructuring in the enterprises was expected, which could generally result in reduced employment in the short term. Anxiety on the part of the employees therefore was expected. With a view to facilitate smooth transition from public to private management, the government showed genuine concern about the possible impact it would create on employment. Because of these reasons, the Nepali government introduced certain arrangements to protect the interest of the employees through legal provisions in the Privatization Act of 1994. The provision included, among other things, the promise of continuity of services. In case of retrenchment, the provision provided an arrangement for a reasonable compensation and continuation of facilities at a level not less than that enjoyed before privatization.

For the purpose of employment analysis, the privatization program of the government can be divided into three distinct phases. In the first phase the total assets of 3 enterprises were sold. In the second phase, certain numbers of shares of 5 enterprises were sold to the management and the assets were liquidated. In the third phase, another 6 enterprises were privatized through various modalities, including management contracts, leases, sales of management shares and partial sales of government shares and assets.

Since 1998, the privatization process has been much slower because of the political instability in Nepal; the government has changed three times within one year. The government could not monitor the privatization program fully due to the poor security situation. The Maoist problem has affected all of the politics, economics and culture in Nepal.

Foreign investment has stopped, and none of the domestic investors are willing to invest in any sectors. The privatized enterprises have not improved their performance and have not increased job opportunity because of the lack of corporate governance. The healthy enterprises were also liquidated or dissolved after privatization. Some of the enterprises that were moving their location bought land at a high price and have now liquidated. The problem was that the government did not monitor in time. It seems that only the owners of such companies profited through the privatization program.

Table 2. Employment changes after privatization in Nepal

Enterprises	Number of Employees Before Privatization	Number of Employees After Privatization
Bhrikuti Paper and Pulp	297	970
Harisiddhi Bricks and Tiles	602	545
Banshbari Shoe Factory	478	70
Raw Hide Collection Factory	564	0 (Liquidation)
Agriculture Tools Factory	283	278 (Now closed)
Balaju Textile Industry.	196	101 (Now closed)
Total	2,420	1,964

Source: His Majesty's Government of Nepal [17], 1999.

The Nepal Privatization Act, Article 14, provides full security against possible layoffs and curtailment in the benefits and facilities that employees of privatized units enjoyed. Managers, on the other hand, claim that this legal provision has effectively tied their hands and curtailed their freedom to manage their enterprises. There is some inconsistency in the Privatization Act. The Act seems to have been drawn up without considering the prevailing Labour Act and the Industrial Enterprises Act.

2.5 Privatization's Impact on Employment: Initial Conditions Matter

In many developing countries, labour unions have feared that privatization will have a negative effect on labour. The government has retrenched the unnecessary labour force

before preparing for privatization. The new investor would not like to take responsibility for labour pensions or severance allowances. For the pre-reforms of enterprise, the government has made retired labour a priority. Some of the developing countries governments have pushed out the labour without any severance allowance, but some have preferred the 'golden hand shake' scheme (where employees are given a lump sum for retirement or due to their redundancy). Labour force reduction has often accompanied the privatization and exposure to competition of large and inefficient firms. On the other hand, many enterprises, particularly those already operating in a competitive market, have been sold with their labour force intact. Moreover, privatization has often created new jobs as a result of new investments and dynamic expansion. In general, the privatization program carries out labour reforms (Kikeri [23], 1998). For example, Chile began extensive labour market reforms in the early 1970s by rationalizing state enterprises' employment and wages and changing labour market regulations regarding the hiring and firing workers. These reforms led to significant employment reductions by the early 1980s in both public and private firms (Hachette and Rolf [14], 1993). Some of Nepal's privatized firms even increased the number of labourers after privatization. In some cases, after the privatization, new technologies have entered these firms. SOE workers are not well trained for the new technology, and some labourers are not competent due to lack of education. These unskilled labourers may be pushed into retirement. However, large employment reductions have often accompanied the privatization of state enterprises that were, in the past, heavily subsidized and protected from competition.

2.6 Privatization of Public Enterprises in Nepal

Privatization in South Asia has been a strategy grown out of socio-economic compulsions rather than choice. This region adopted mixed economy principles. The state is occupying the commanding role in this socio-economic development endeavour. This policy, thought instrumental in making certain progress toward the establishment of social-economic infrastructure and the initiation of the industrialization process, not only fell short of envisaged expectations, but even the reasonable needs and requirements of the people could not be adequately addressed. While the private sector largely remained shy and underdeveloped, on account of the pursuance of such a control-oriented and state-dominated development strategy, the benefits of dynamic private sector involvement and competitive markets could not be available to the economy in the level of economic transformation in Nepal and other countries in Asia. In short, the state-dominated development strategy came to be identified as a prominent factor for the spectre of

massive underdevelopment and poverty that the region has experienced over the years.

The last two decades, however, witnessed a momentous change and restructuring in the economic spectrum of this region. There has been a transformation in the economic policy regime. Questions were asked as to the justifiability of the previously adopted regime. While the imperative of the new reform initiatives and strategy increasingly received wider acceptance, the private sectors came to be recognized as a dynamic and inevitable force of rapid economic progress. As economic decentralization, openness and market-oriented reforms widened their frontier, a range of activities and processes hitherto reserved for the government came to be gradually transferred to the hands of the private sector and market mechanisms. The force of economic liberalization, delicensing and deregulation redefined and reprioritized many of the functions and responsibilities of the government's involvement and interference in the economy; this was echoed by the strong opinion that it was essential to cut bureaucracy out of all businesses. It is in this perspective that we see the need for promoting the private sector's growth and its contribution to the economy. Carrying out core governmental responsibilities more efficiently and effectively and enhancing productive investment to make more competitiveness will realize the development goals quickly and sustain the strategy of privatization. This proved that it deserved its rightful place in the policy and became proactive of the new socio-economic milieu of the region.

In Nepal, privatization started earnestly when the newly-elected government launched the program in 1992, though the then government had come up with in 1985 an ambitious plan to privatize 12 public enterprises (PEs) at a rate of one PE per month in 1985. However, it resulted in no actual achievement. The privatization program was part of the overall economic strategy leading the economy toward the new strength and vigour and realized rapid industrialization based on increasingly private participation in industrial activities in Nepal. It also involved enhancing the quality of public resource management, raising the efficiency of investment and refocusing government functions, priorities and resources on those areas identified as the most instrumental and critical for ensuring a self-sustained and viable economic development pattern in the economy. Three manufacturing enterprises were privatized in 1992, four in 1993 and three in 1994. All together 16 enterprises were privatized. Share sale modality was adopted, 9 were business and assets sales, 3 were liquidation, and 1 was given to management contract and lease. At present there are 43 public enterprises out of which 30 public enterprises are slated for privatization during the *Nepal Ninth plan* (1997-2002).

Although there are no disputes as to the merits and disadvantages, a well-designed and implemented privatization strategy would be accrued to the stakeholders including the consumers. The complexity and a host of interests involved in the privatization are bound to make the process a tough, delicate and important one. It is understandable that the successful implementation of this strategy rests on how adequately and appropriately the complexities and the multiplicity of these interests and concerns have been taken into active consideration. It may be noted that many dimensions are involved, like the selection of enterprises, timing and pace of restructuring the enterprises (use of assets and settlement of liabilities continuing or otherwise of the existing line of business), employment (its level, flexibility to the investors), choice of investors (domestic and foreign price criterion vs. technical commercial capability), regulation (privatization of monopoly or natural monopoly and introduction of competition), and use of sale proceeds. These dimensions warrant serious thought and action in the privatization process. The commitment of the authorities ensuring highest possible degree of transparency improved public awareness through dissemination of knowledge and ideas, and the regular monitoring of the privatization results for the utilization of the lessons for the future constitutes areas that underlay its success. Accordingly, countries in the region have devised policy foundations, legislative frameworks, and privatization processes that are adequately comprehensive and conducive to economies, though the details and refinement with the stage of progress vary greatly.

In Nepal it was relatively easy for PEs to be set up due to the attractive governmental loans that were available at the time. These 7 year loans stated that the first two years were interest-free, and interest would only accrue from the beginning of year 3 to the end of 7th year. As only the outstanding balance was subject to interest, there was more cash on hand, and it was easier to set realistic objectives for businesses. Most PEs set a five-year plan of objectives, and these objectives were created as a guideline not only for production, but also for achieving socio-economic policies of the government. This initiative of the government was essential and justified at the time when private sector investment was not forthcoming in the provision of basic social services, and when the public utility sector's investment was exceeding. The number of such enterprises in the industries of social services was 12, while public utility sectors exceeded 60. Many of them were established with the assistance of donor countries. From these public sector organizations, it was expected that they would create an industrial base in the country, enhance domestic production, substitute imports, generate employment opportunities, and contribute to the national treasury. But most PEs were characterized by operating

deficits, overstaffing, heavy dependence on credit, and inefficient management and low capacity utilization. They are mostly involved in trade, industry and service related enterprises (i.e., Nepal Telecom, Nepal Electricity).

On the basis of analysis and evaluation of the role and performance of these enterprises, the elected government, which assumed power after the restoration of democracy in 1990, concluded that the economic condition and financial efficiency of the government corporations were unsatisfactory. Lack of the basic necessary elements for improving their performance, PEs confronted with the various problems and hindrance such as lack of managerial autonomy, inefficient use of means and resources, short sightedness and weakness on the part of political leadership, low quality goods and services, uncontrolled administration expenses, lack of motivation in incumbent human resources, adopted traditional technology and minimum use of professionalism. All these factors brought about a progressive decline in their output and made the vast amount of government investment unproductive. Thus, these public corporations have not only failed to achieve their objectives but also become a heavy burden on the national economy.

Nepal implemented a Structural Adjustment Program (SAP) as early as in 1985, which included tariff rationalization, reduction of fiscal deficits and privatization of PEs. The efforts materialized in 1990, when the political system in Nepal was changed and a market economic system was adopted.

3. Change in the terms and condition of labour service in Nepal: Case Study

The productivity gains from employment cuts have often resulted in wage improvement for employees who remained with privatized firms. In Nepal, some of the enterprises have increased wages by about 10-12%. At the time of the privatization contract between the government and buyers, the clause was put in the contract that “the new buyers would not reduce the salary scale of employees before SOEs were taken over”, but there was not any provision for increasing their salary according to price movement. Most of the enterprises did not increase the salary of employees after privatization. The labour unions are constantly in dispute with management regarding this issue.

The major employment providers in Nepal were in the public sector. Table 3 shows the employment growth since 1975. The highest employment growth took place in 1990 at about 59,550. After adopting the privatization policy, employment growth started to

decrease every year thereafter. Some enterprises were liquidated by the government, whose scrap value was zero or nothing. Some of the enterprises were alive by the softened budget of the government. After privatization, the new investor could not run or expand, and it has profited by closing down the enterprises. After adopting an open-market economic policy, the Nepali markets are free to import goods from third countries. As a result of this, Nepali goods lost their status in their own market. The consumers are attracted to foreign goods, and Nepali products have not maintained quality and are unable to compete with the third world countries' products.

3.1 De-unionization

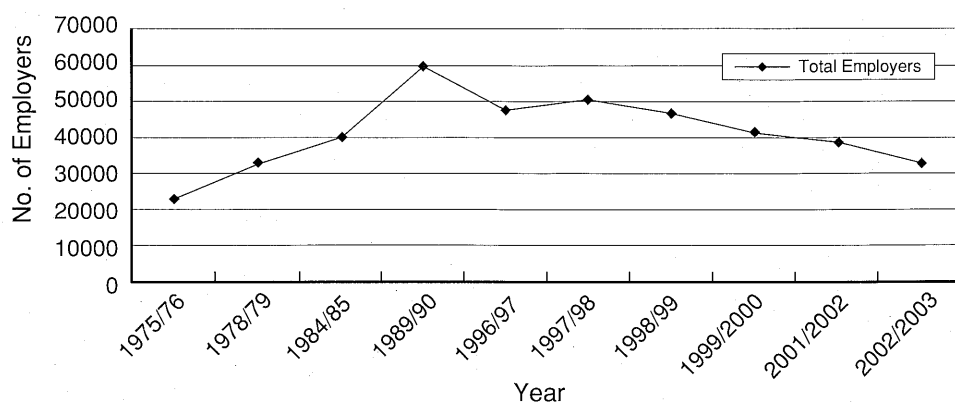
In some developing countries, new private owners want to motivate the labour force in their work by providing some share in the enterprises at a cheap rate. The labourers now share in the company interests and may lose touch with the labour unions. With diminishing numbers in the labour unions, the labour and management relationship has improved.¹⁾ The labourers were not motivated by interest in political parties. In Nepal, the Butwal Power Company has provided 2 percent in total share for the labourers at a cheap rate.

Table 3. Growth of Employment in Public Enterprises in Nepal

Years	Numbers Employed in Public Enterprises
1975/1976	23,133
1978/1979	32,923
1984/1985	40,221
1989/1990	59,550
1996/1997	47,548
1997/1998	50,346
1998/1999	46,733
1999/2000	41,516
2001/2002	38,419
2002/2003	32,648
2003/2004	N.A.

Source: This table was constructed by the authors based on the data from CBS [3], Guru-Gharana [13], ILO [19] and MOF [34].

Figure 2. Employment in Public Enterprises in Nepal: 1975-2003



Source: The same as above.

3.2 New Job Creation

In some of the developing countries after privatization, the new ownership has expanded their enterprises. The new, larger firm has recruited new labour. In Nepal, the government has forced new owners to give preference to the now unemployed staff of SOEs at the time of recruitment. The Bhrikuti Paper Industries has increased its number of labourers by 60 percent. At Harisiddhi Bricks and Tile, the work force has increased by 20%, and while Butwal Power Company did not increase the work force, there has been an increase in facilities and a bonus scheme for labourers was introduced.²⁾

In conclusion, the evidence shows a wide range of results with respect to privatization's effects on workers. Privatization can bring significant benefits to workers in enterprises operating in competitive markets where overstaffing is limited and where new owners are willing to maintain some excess staff to keep the political and social peace. Privatization can bring an improved environment and attitude to a company. New investment brings new technology, management and new products into developing countries which increase the satisfaction of the workers who are pleased with the new benefits.

3.3 Argument for Privatization

The PEs are not necessarily effective in providing services. The government has subsidized public companies to provide cheaper products to people. PEs are a financial burden. While pursuing the privatization policy, the government has broadly enunciated three major policy goals: they are (1) reducing financial and administrative burden, (2)

improving operational efficiency of the PEs and (3) involving public participation in the ownership and management of PEs. Privatization would reduce financial and administrative burden. PEs have consistently drained rather than developed national resources. Their poor performance record has been a drag on the National Treasury in Nepal. Every year, the government has injected a huge sum of money in the form of capital, loans and subsidies into public enterprises. On the average, the funding of PEs accounts for 30 percent of the budget deficit for the period of 1983-2000 in Nepal. The total net flow of funds between government and PEs was found to be negative, meaning that there was more flow of funds from the government to the PEs than the return from them. The flow of funds from the government to the PEs was 23% per annum; however, the flow of funds from PEs was only 17% per annum. It was therefore proven that the PEs were a financial burden on the government.

3.4 Case study: Bhrikuti Pulp and Paper (Nepal) Limited (BPPL)

Bhrikuti Pulp and Paper Limited (BPPL) was established in 1982 under the Nepal Company Act (1964) with technical assistance from the Government of The People's Republic of China. It has achieved its aims to produce machine-made good quality writing and printing paper to fulfil domestic demand. After entering the modern economy, the demand for paper in Nepal is greater than ever before. Nepal has sufficient natural resources to produce paper. Until then, Nepal had depended on imported paper from India and other third-world countries. The cost of importation was very high, and the amount imported was not sufficient to meet domestic demand.

BPPL is located on the bank of Narayani River, 1.5 kilometres west of Narangrah town, in Gaidakot in Nawalparasi district. It started to produce paper in the years 1986/87. Although, the installed capacity of this unit was 4,550 metric tons per annum till now, it has produced only 3,000 m/t per annum. Due to the low production capacity, the factory was not viable economically. Its assets and liabilities before privatization were in Nepali Rupees 83.8 million and 24.6 million respectively. The Rupee is the Nepali currency, 72 Rupees is equivalent to 1 US\$. It was necessary to inject additional capital for further expansion. The performance of the factory did not drop. It paid bonuses and other allowances and provided medical facilities for the workers. The demand for paper was growing gradually, and the company could not meet domestic demand. While other small paper producers were also in operation, their production was very low and they did not produce printing paper. After 1992, the first elected government had considered privatizing BPPL with the aim of increasing the expansion of industries, production and

job opportunities.

Reason for Privatization

As mentioned earlier, the main objective behind the establishment of BPPL was to fulfil the domestic demand for machine-made writing and printing paper in Nepal. However, this objective was hardly fulfilled as the mill could only account for 10 percent of total national demand. Moreover, its performance started deteriorating after 1989/90 due to unavailability of investment for expansion and modernization, limited technical know-how and improper management. After 1990, the first elected government had placed emphasis on improving the literacy rate in Nepal. Most of the private educational institutions were open to all, and the government aimed to have 100% of children enrolled in primary school. With the introduction of freedom of the press, an enormous number of new newspapers started to open. Obviously, the new companies and other economic activities also increased. Moreover, the demand for paper for writing and printing was rising very quickly. BPPL needed to expand its production capacity, and new technology and new buildings were thereby necessary. The government was unable to finance this factory expansion, and realized that privatization was the easiest way to grow investment.

Being a SOE, BPPL also suffered from unnecessary recruitment through political and bureaucratic appointments. Moreover, paper-mill works being a highly technical type of manufacturing, these appointees were like “a large edible nut put into a cat’s mouth”. Before privatization, the enterprise had suffered from a poor management style. The management of the enterprises were appointed from the department of central government, although they had neither experience in entrepreneurship and technology nor any experience in marketing and consumer behaviour. The lack of expertise made it very difficult to make decisions on time.

This data was used in this paper as primary sources. The first author had visited the BPPL and interviewed both labour and management in March, 2004. At that time, we found that a conflict between management and labour concerning allowance and salary. Labour told us that management had expanded the enterprises, introduced new technology and that the capacity of factory was near to full capacity. Besides this, they had complained to the government that the new management had not followed the initial contract with labour about salaries, health allowances and other insurance. The government was unresponsive to the labour complaints. The new management (Golcha Organization) was against the complaints of the labour. They told us that “we had given many facilities to our workers, which we are now at the maximum. We urge our workers to

compare themselves with other enterprises!”.

Table 4 shows the figures of production and sales of BPPL. The enterprise had produced 1,500 m/t and a sale was 1,310 m/t before privatization. After privatization this figure increased to 8,640 m/t and sales were the same at 8,640 m/t. The enterprise was projected to increase production and sales up to 32,000 m/t in the coming five years (2002-2007). After privatization, the enterprise was raising production and sales units in short terms with the same labour force and technology of production. It has proved that public enterprises are outdated for increasing the performance of enterprises and jobs. After privatization, the new management group has imported new technology and built up other necessary infrastructure like buildings, land and machinery.

Capacity Utilization

The BPPL had utilized their capacity only 75 percent before the privatization period. It has increased to 90 percent after two years of privatization, and it is projected (until 2007) to use all of the capacity and produce 32,000 m/t in a year. The enterprise has adopted many other new technologies. Before privatization, it had produced only writing paper for domestic demand. After privatization, it has started to produce printing paper and for newsprint. Moreover, it has started to produce pulp for exporting to third countries like Japan, Germany, Australia and other many industrial countries.

Employment

The objective of this field work was to find if there was growth of employment after privatization of SOEs. In BPPL, the amount of employment grew after privatization. At the moment of privatization, the new management reduced the number of some labourers, who were unskilled workers. But after some time, the enterprise was expanding its production size. It has needed to create three shifts, and employment has grown extremely by many times.

Table 4. Production and Sales of Bhrikuti Pulp and Paper Limited.

	Before Privatization	After Privatization	Projected
Production	1,500	8,640	32,000
Sales	1,310	8,640	32,000

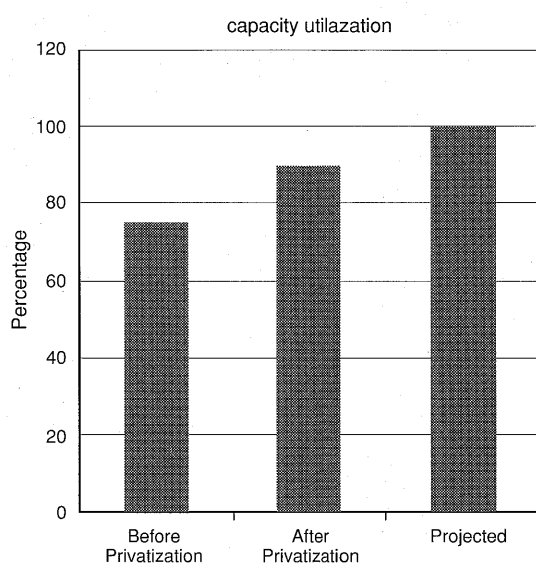
Source: Internal unpublished data of BPPL³⁾

Table: 5 Capacity Utilization After Privatization in BPPL

	Before Privatization	After Privatization	Projected
Capacity utilization	75	90	100

Source: Internal unpublished data of BPPL

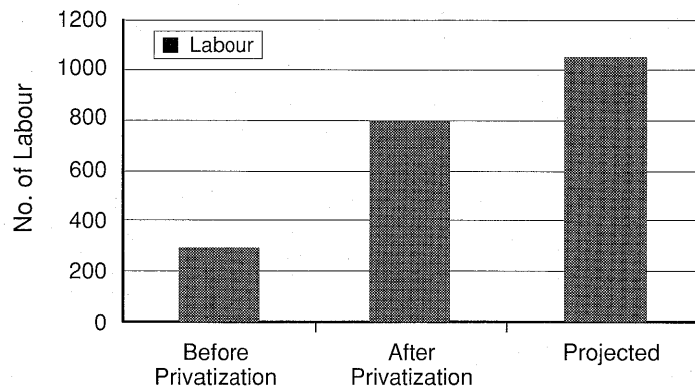
Figure 3. Capacity Utilization of BPPL Before and After Privatization



Source: Internal unpublished data of BPPL

Before privatization, 297 labourers were engaged and only 10 tons of paper were produced per day. Labour productivity was low before privatization and actually they produced only 9.42 tons before privatization. After privatization, the ratio per labour was 11.66 tons produced and 30 tons per day production, and about 800 people are employed now. During peak season about 950 labourer are engaged. The company is projected to require 1,050 labourers in all of the seasons in 2007.

Figure 4. Labour Employed Before and After Privatization



Source: Internal unpublished data of BPPL

Positive impact of privatization in BPPL

Production capacity: Management has a plan to increase the production capacity gradually from 10 tons per day to 128 tons per day. The Installation of additional plants and machinery has already started since privatization. It will definitely increase both direct and indirect employment. Production has increased by 50 percent since privatization.

Indirect employment: Many people from various districts of western Nepal are now engaged in collecting sabi grass and dried straw that are used as the main raw material for making paper. Thus, the rural people of the area use their spare time to collect these necessary raw materials and earn extra money. This is domestic job creation. It has further increased subcontracting job opportunities like collecting dried sabi grass, straw and waste paper jobs, which women can do also. Employment has been also increased by 30-35 percent.

Technology transfer: Before privatization, the factory used coal, which is imported from nearby county India. It paid huge amount of foreign currency for importing; it paid a lot of money for electricity. After privatization, the new management has imported new technology, which can use rice husks instead of coal and electricity. It saves a lot of foreign currency and electricity cost and energy.

Competition: BPPL has enjoyed a monopoly in the paper market, supplying state-owned printing companies and government offices. After privatization, these enterprises are free to enjoy market competition and to examine the price of paper in market competition, and to have a wider span of purchase choices.

Negative impact after privatization of BPPL

Increase in pollution: An increase in pollution is a key issue raised after privatization. BPPL has drained waste chemicals and by-products into the Narayani River (which is one of the biggest rivers of Nepal). It has created an ecological imbalance. Before privatization, BPPL was an SOE, so people could not raise a voice against or receive a response by the government. In the new open environment, many environment-related NGOs have opened and they are teaching the importance of environment balance. They are raising environmental awareness and protesting pollution.

Recruitment of non-Nepali workers: After privatization, the owners were free to operate enterprises. They imported skilled and cheap labour from India without training Nepali labour. They wanted to make production costs cheaper. If they imported non-Nepali labour, it is not necessary to give insurance, educational allowance for their children, medical allowances and bonuses. It does not provide a permanent job and they do not need to give them pensions or gratuities when they finish.

Temporary labour policy: After privatization, management started to cut their full time workers. Instead, they started to hire temporary labour for short terms. In the peak season, they engaged a lot of local labour, and in the off season they automatically leave. The daily wage system has given the new owners a free choice of labour forces.

4. Conclusion

Privatization is an essential tool for transforming government-controlled economies into market-oriented economies. Privatization is most effective when it is part of a broader program of economic reforms and private sector development. It is true that within a relatively short period of time, Nepal has made some progress in introducing a new concept of market economy like privatization programs for improving its serious economic instability.

Our preceding analysis contends that privatization has had an overall positive impact on employment conditions. The enterprises have given new opportunities for labour to learn about new advanced technology, and to increase their performance, productivity and competitive nature. They should be competing in the job market for new jobs, if they leave their present enterprises. After privatization, employment would decrease for a short period. However, after some time, employment would increase more than before privatization. Our field work research showed that the number of labourer increased after privatization in BPPL. If we compared this with all the data of Nepal, employment certainly decreased more than before, but there are many reasons; many of the enterprises were insolvent before privatization, and some failed in a new competitive environment. Our data proved that the status of employment on privatized enterprises improved compared to before.

No one of the policies has all good points, and of course any policy has both bad and good aspects. We need to compare that which are more numerous. It is evident that the overall performance of privatized enterprises in Nepal has not been up to the mark. The impact of privatization both on macro and micro economics of Nepal has been mixed, but its impact has been good on overall employment and performance of enterprises. For achieving a fruitful utilization of privatization programs, Nepal must put more concern into the market economic system.

The willingness and ability of foreign and domestic investors to participate in privatization and private enterprise development usually depend not only on the success of macroeconomic policy reforms, but also on the ability of governments to establish effective market institutions and to provide support for the private sector. Effective market economies need successful privatization programs in a new market-oriented economy in developing countries.

Notes

- 1) The first author has an interview with BPC (Butwal Power Company) management personnel in October, 2004 at the time of his field work.
- 2) These data were collected at the time of the first author's field study in October, 2004.
- 3) The first author had asked them to use these unpublished data for his academic paper at that time. They gave permission.

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