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Mallika Shakya:

I totally agree with Keshav Upadhyay in almost everything he says. Nepal has a generation of young people who have been brought up with the belief that Nepal is one of the richest sources of hydropower, only to discover later that FDI in our hydropower has left us poorer than before, while the same hydropower has comfortably doubled the GNP per capita for Bhutan.

Private sector investment is sorely needed for hydropower, but some of the initial experimentations seem to have gone so bad that unless the State corrects this serious market distortion, it thwarts hydro-FDI potentials considerably. The solution to this, in my opinion, is not to abandon FDI but to change its modality. FDI does not automatically instigate competition among investors nor does it entail automatic technology transfer. As I mentioned in my paper, the contrast between the FDI in China and Africa shows that FDI is not a natural panacea, it must be forced and tailored into delivery of technology transfer and cost-efficiency. Have we made efforts to learn from experimentations in South and East Asia on this? For example, Bangladesh has recently set up a Power Facility where the State (or donors) will provide guarantee and extend subsidized credit for the public infrastructure goods with longer gestation period while the commercial/competitive private investment would be sought for the power generation and distribution at sustainable rates. This might actually encourage domestic private sector investment vs. FDI at least in some areas. This might actually also revitalize the banking system if done well.

The success or failure, again, will lie not in 'thick' modaliy, but in subtle calculations and modeling. This is where I put the question back to the commentator as well as others in this forum who have dense experience in this area. What are the precise lessons learnt from Nepal's few experimentations in this area? Which are the specific areas where expertise is lacking within the country? How can they be fulfilled? Who can help Nepal strengthen its skills? Some donors? Strong business consultants? Non-resident Nepalis with technical skills? Technicians within the country?

Keshav Upadhyay, Engineer, Nepal Electricity Authority (NEA):

Mallika Shakya has written a lucid essay on the issues relevant for drafting a workable strategy of Private Sector Development (PSD) in a transitional Nepal. She has pointed her finger at the interventions required to address the "ethnic and gender concerns without self destructive compromises on market rigor". Since the redress of ethnic and gender concerns would definitely distort the market in some ways it is here that I am not comfortable with her prognosis though I would very much like to agree entirely with her because the concerns are genuine. It is not that there is any argument with the politico-economic agenda of inclusive democracy; it is the question of strategy which is a matter of debate. Though the country's politics has visibly veered towards far left, there is no point in developing a strategy of PSD for an extreme left regime that would give no role to the private sector. A realistic PSD strategy has to dovetail into the socio-economic agenda of the liberal left; otherwise the whole exercise could turn into idle play of words. Small pillars of the economy like micro credit and cooperative initiatives, I am sure, would fit seamlessly into the new scheme of things, so the stress would naturally go in that direction. But, as the author has rightly stated, there are some sectors where inducing bigger investments would require a totally different approach.

To take an example, Nepal has seen the inflow of foreign direct investment (FDI) in the sector of electricity generation (the 60mw Khimti from Norwegian Statkraft and the 36mw Bhotekoshi from Panda Energy of USA), and this has vitiated the market in such a way that FDI in power sector has now become an anathema. They have been instrumental in raising retail electricity rates to the extent that a further rate increase would never be politically acceptable. If, however, the retail rates are not raised, the Nepal Electricity Authority (NEA) would go into financial bankruptcy.

In fact, so far as FDI in the power sector is concerned, everything which Ms. Shakya warns against has happened here. It has distorted the price, and is neither cost effective nor market friendly. NEA is very apprehensive of entering into new power purchase agreements because of its bitter experience in the past. Therefore, not enough investment from the private sector is coming into this sector. NEA has been continuously in the red for half a decade now and is, without a surplus, not in a position to invest. The government, on the other hand, does not treat electricity as infrastructure but rather as a commercial commodity, and recent utterances of the finance minister confirm this. The only option that remains is the national private sector which is also hampered by archaic rules and regulations unfriendly to investment.

To give an example, it takes almost two years for a power project to get a clearance from the environment ministry after submission of the Environment Impact Assessment (EIA). Two years is an average period. There have been cases where some procedural reasons force the whole assessment exercise to be repeated. Secondly, the size of investible funds may be difficult to mobilize. My estimates indicate a figure of nine billion rupees that must be invested annually to meet the rising demand of 60mw per year. Is our banking system capable of lending this amount of money where the return on investment starts trickling in only after five years at the least? Meanwhile the country is reeling under a severe power crisis leading to a blackout of six hours per day for we don't know how long.

I wanted to show with examples from the power industry that when the economy is too immature, the entry of private sector does not automatically bring in the benefits that are classically attributed to it. Resources may not get allocated to the sector where there is a possibility of maximum gain, at least in terms of the social rates of return, or prices may not stay high enough to sustain investment at a desired rate. The author's instincts, though, are in the right place and I entirely agree with Ms. Shakya that the political economy of new Nepal would lie somewhere between capitalistic anarchy and a rigid central planning of a socialist state. In such a framework for development, the role of state cannot be minimal.