

e-Seminar Title: Nepal PSD

Subject: Federal Structure, Hydropower, State Regulation and FDI – Summary of February 25 and 26 Deliberations

Contributors: Vijaya R. Sharma, Ambika P. Adhikari, Mallika Shakya, Dileep Adhikay and Hari B. Jha (Editorial Summary by Vijaya R. Sharma, Co-Moderator)

Date: February 25 and 26, 2007

Issues related to two areas – the prospective federal structure of the country and the hydropower – have been discussed in the last two days.

Deliberations on Federal Structure

Vijaya R. Sharma:

I like to draw your attention to also the prospective federal system that Nepal would have in near future. Will the federal system be or can it be made more conducive to PSD? Having many provincial governments, would it facilitate the implementation of community-managed schools (as suggested by MeenaJee), setting up education trust funds at the level of provinces (suggested by AlokJee), expanding +2 schooling system for supply of middle level technicians, and/or launching of niche ethnic branding of specialty products (suggested by MallikaJee)? Should the promotion of all non-FDI business ventures be left to the provincial governments? Just as increased competition raises the efficiency of the market, increased competition among provinces may improve efficiency of governmental services (subject to the hard budget constraint that provinces must balance their budget). What should be the approach to empower provincial governments in the interest of PSD?

Deliberations on Hydropower, State Regulation and FDI

Ambika Adhikari

Prior to 1992, it was the conventional wisdom that big hydropower projects would be developed by government, through foreign assistance and by government owned public authorities. The concept of privatizing hydropower basically began in 1992 after the hydro-power act. At the initial phase, the Electricity Development Center (EDC) prepared a menu of potential and viable projects and offered them for development to international companies. A few foreign private companies did develop some initial ones e.g. Bhote Koshi I and II, Upper Marsyangdi and Upper Karnali. So big was the euphoria at that time that many Nepali investors and promoters even invited the now bankrupt Enron to develop the biggest prize of all, the gigantic lower Karnali project.

The private sector power development did face hurdles. The Bhote Koshi power purchase agreement generated much controversy inviting intervention from the US government and law suits from the private developer. On the other hand, some local Nepali invested smaller projects have become successful and profitable. They catered to the available

demand, utilized local man-power and professional expertise, and were much better grounded in the local reality.

In my opinion, a major problem faced by the middle and large sized foreign developed projects is the difficulties in accessing the Indian market. Although some experts have talked about it, no one has seriously explored the national consumption potential, and increasing the domestic demands for power in the interim. The many black-outs, load-shedding and lack of power for industries are proving that there is enough domestic demand for power in Nepal. Further, with the rise of income that is anticipated in the post-conflict Nepal, the emerging Nepali economy should be able to absorb power from several small and medium size projects.

Mallika Shakya:

First, we agree that hydro-investment has to come from the private sector and the public sector should facilitate it. Here do we have a good model for public-private-partnership that would satisfy the demands of investment, financial efficiency and knowledge transfer? The need to rid NEA of political appointments and outdated knowledge is well established. Can this be achieved in practice? And is the problem all political? What technical capacity is NEA lacking which makes its performance so dismal? Maybe it is NEA that has to be privatized, especially in facilitating smaller projects more efficiently, as Dileep Ji has pointed out.

Second is the role of ADB and other multilaterals in promoting Nepali hydropower in the Indian market. Has ADB done this for any other countries? Some of the examples from East Asia, if this is the basis for our hope on ADB, might actually be less relevant for South Asia simply on the grounds that East Asia enjoys far better regionalism than South Asia and hence persuading powerful neighbours might be an easier task there. How about multinational business strategy companies who might specialise precisely on hydro issues?

Third, I agree that the Indian State is not interested in Nepali hydro, but I am still not convinced (and I might sound a bit stubborn here). Why do we fully exclude the possibility that the Indian private sector might be interested after all? If there is a market demand, what stops them from exploring new economic opportunities in Nepal especially when they have a competitive advantage over others on knowledge and information? For example, Bangladesh has been totally unsuccessful in selling its gas to India, but Tata is very much making its entrance there. Are we exploring that possibility at all?

These same issues might be very much relevant for various other industrial sectors, e.g., roads, telecom, IT, tourism, etc.

Dileep K Adhikary:

Firstly, hydro-electricity (HE) is basically a commercial project, which should not be a government project, but a private sector project. Therefore, neither Nepal government nor India government nor any other government could be a promoter. But the private sector from anywhere who dares to venture could promote it.

Secondly, interest of India on Nepal is not on getting electric power but on securing water supplies.

Thirdly, with the above clarity engage multi-lateral agencies like ADB as the go-between, even for the promotion of Private HE with India as a market.

Fourthly, the Nepal Government has serious limitations to provide funds for NEA to make investments, and NEA has serious limitations of its own income to generate surplus for investments.

Fifthly, the current banking regulations in NEPAL are of no help to promote even medium size (60-100MW) projects.

Sixthly, the current practices for micro/small projects are based on milking NEA not on the basis of competitiveness.

Seventhly, in developing HE to the desired/competitive level unbundling of NEA is also a critical requirement.

Hari B. Jha:

Nepal's hydropower sector has failed to grow. The main factor is the mind-set. We neither do on our own nor allow the others to contribute in this sector. In regard to external investors, we have a mind-set that we will be cheated if we make a deal. Mahakali Project is a glaring example. Despite the fact that the Project was framed on the basis of equal participation both in investment and returns, we did not allow it to materialize so far. Even in project such as Arun III, we did not go forward though it is most feasible project. If at all we have shown interest in certain projects such as in Marsyangdi and a few others, it is just because it served the vested interests of certain groups. Therefore, the main problem is educating us. We have to come out of the well and make meaningful dialogue maybe with our neighbours or agencies outside the region for making best utilization of this scarce resource. But for all this the mind-set has to be changed and vision created that Nepal needs to be made an affluent country rather than a country moving with begging bowl.