

MSE Policy Review in Nepal: Current Reform Process in Government

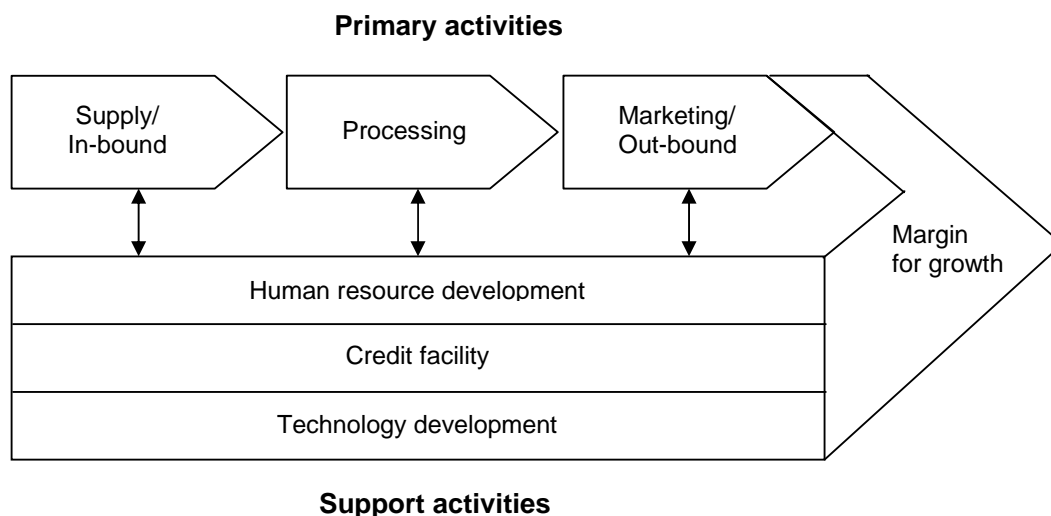
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1. Conceptualization: MSE Value Chain for Development

Poverty reduction has been the foremost development objective of Nepal since it embarked on planned development efforts almost half a century ago. Given the country's geo-political condition and small economic scale, the micro and small enterprises (MSE) sector has been the backbone of the country's off-farm economic scenario spanning throughout the three ecological regions and the major source of employment to the largely agrarian rural population. MSEs represent micro-enterprises slightly graduated to small scale enterprises. So far, the industrial development efforts have been emphasizing on the small and medium-sized enterprises (SMEs) and the fewer large enterprises only. Most of these are either closing down or are manifest with poor performance, low productivity and lack of competitiveness due to a number of factors including their dependence on foreign resources. The contribution and prospects of MSE sector in the economy and its wider dynamics has been grossly underestimated, as reflected by the lack focus and clarity regarding the sector. It is an accepted fact that a sustained growth of the economy, especially in a country like Nepal, can only be possible with a strong MSE sector supported by a concerted policy backing of the government.

The development of MSE sector can be better understood in the context of its value chain. The value-chain model of Michael Porter puts the total value-chain in perspective – in which supply (in-bound), processing and marketing (out-bound) are primarily responsible for increasing the value chain, whereas, human resource development, credit facility and technology transfer are the necessary support services. (Refer Figure 1)

Value-chain model of MSEs



Each link existing in the form of raw material supplier or processor or marketing in the basic value chain has to be seen and developed as fully sustaining micro-enterprise having the potential competitive advantage over other larger enterprises. These individual components in the value chain need to be supported by appropriate technology development and research, HRD, credit facilities etc. As Nepal is very much in the threshold of globalization and overall process of liberalization, strengthening of each chain for developing competitive advantage and sustainability at individual level assumes greater importance. Nepal's potential in agricultural and forest resources is yet to be fully exploited for the benefit of the industries by reducing dependence on foreign materials. Most micro-enterprises use low cost indigenous or adopted technology to process the inputs. More efficient means can be developed with adequate research. There is a growing market for the MSE sector, but this is yet to be fully harnessed. Micro-enterprises have had to compete in the market with similar local enterprises although their marketing channels mostly constitute of direct marketing such as local haat bazaar. Appropriate market linkages, skill training, knowledge of business management and administration, timely and adequate credit facility, etc. are the minimum requirements for the development of these micro-enterprises. Only then can micro-enterprises gain through creation of adequate margin required for growth. The value chain of manufacturing MSEs and service generating micro-enterprises may slightly differ in content, but the overall structure is quite similar.

2. Methodology: Mindset Change Pattern for Policy Reform Process

The effective strengthening of such a value chain and its promotion in right perspective is contingent to favorable policies and legislations and institutionalization of the MSE promotion mechanism, which, in effect, is possible with positive mindset of the government in general, and toward this MSE sector in particular. It would not be wrong to assume that the policy reform process in any sector development will by and large be guided by the change in the mindset of the government. The country has undergone major political and socio-economic change since the early 1990s. One way of understanding the mind set change of the government is to examine the changes in policy regulatory structures in three stages – the Panchayat period in the 1980s, the transitional period of the 1990s and the current reforms taking place or being considered. This mindset in general reflects fast changes especially in the onset of globalization and the country's adoption of economic reforms since the early 1980s, which rapidly accelerated in the 1990s. It is important to examine the reform process in the MSE sector policies in the light of this mindset change.

The value chain system of micro-enterprises vis-à-vis policy and regulatory structures (documents, acts and regulations) corresponding to each chain and the support systems of the value chain has been mapped to illustrate the existence or lack of coverage of each chain by the documents. This exercise provides the scope for examining the mindset of the government regarding the MSE sector.

The pattern of mindset change of the government has been put into perspective by examining the policy changes taking place in the 80s decade (pre democracy), the 90s decade (after the restoration of democracy), and the current reform process taking place. This involved examination of government's policy regarding MSE development and interrelated policy documents of other sectors with implications on MSEs. Specific focus on

MSE sector in Nepal is lacking, but a close examination of policy implications at each value chain provides understanding of the existing gaps and the need to address these gaps.

Different documents such as the draft Industrial Development Perspective Plan, Vision 2000 and other sectoral plans (agriculture, forestry, etc.), five-year development plans (seventh to ninth plans and the concept document of tenth plan) have been studied. Likewise, sectoral policies on industry, labour, finance, taxation, trade, foreign investment, environment, forestry, etc. as well as implications of decentralization policy, women development policy etc were also examined. The information collected from the documents have been analyzed to infer the mindset change pattern of policy makers for MSEs.

The successful programs for micro-enterprise development initiated by government and non-government organizations with or without support of bilateral and multilateral donor agencies have been studied and the program with demonstrated best practices has been selected to observe its implementation policies and strategies. In this respect, the Micro Enterprise Development Program (MEDEP), a highly successful joint initiative of His Majesty's Government and the United Nations Development Programme (UNDP) has been studied as a best practice in the context of MSE development and promotion in Nepal.

Interviews and discussions with concerned officials and bureaucrats were conducted which shed light on the current policy reforms being undertaken and those in the offing in the near future and in the long perspective. Current reforms being undertaken have also been extracted from available draft reports and other documents. It is difficult to access unpublished reports and many avoid discussions on purportedly confidential matters related to policy matters. However, best efforts have been made to extract as much information as possible from reliable sources.

Emerging issues have been identified after examining the mindset changes since the 80s decade till the current period. These issues have been shared and discussed closely with concerned stakeholders for verification purpose. The issues thus highlighted maybe useful for recommendation in future policy reform. The scope of this study, however, does not call for making recommendations.

The findings of the study have been presented in the following order. Firstly, different initiatives of the government, the NGO sector and the private sector have been described. This provides an idea of various approaches that have been taken by these different sectors with micro enterprise development as one of the goals/sub-goals. Secondly, the Micro-enterprise Development Program (MEDEP) has been overviewed as a successful and ideal model of micro-enterprise development and promotion in Nepal. Thirdly, the mindset change pattern of the government and policy makers has been assessed with a comparison of MSE related structural and regulatory activities introduced during the three phases as mentioned earlier. Lastly, the findings derived from these regarding current reform activities in the MSE policies and verified through interactions with concerned sources indicate the current status as well as the gaps in policy structure.

3. Current initiatives in MSE development

Various initiatives have been taken toward the development of the MSEs encompassing mostly the rural economy in all the ecological regions by different I/NGOs, CBOs,

government and private bodies. Most of these programs are linked with the overall poverty alleviation strategy of the government. Institutional support for market, training, credit and technology services are made available to women, lower income families, and lower caste/tribes in targetted areas. The government is intent on developing MSE sector as a complementary feeder to the medium and larger enterprises, and also as a means to create employment opportunities and to improve the economic status of low-income people. Most of the initiatives are still at the grass roots level allowing for 'first experience' at income generation for the target people who are yet meandering for the sustenance of their lives.

The government has involved various institutions that have developed and tested their own approaches that have roped in micro-enterprise development as one of the activities linked with their overall objectives. A number of initiatives have established multi-linkages for MSE development and integrated with other core sectors such as forestry, natural resources, agriculture, community development etc. Some examples of this approach are as follows:

- Environment and Forestry Enterprises (New Era/USAID) in 8 districts
- Churia Forestry Development (GTZ) in 3 districts
- Community Forestry Development (DANIDA) in 3 districts
- Forestry Program for Livelihood (DFID) in 7 districts
- Sindhuli-Kavre Forestry Development (AUSAID) in 2 districts
- Natural Resources Management Sector (DANIDA) in 17 districts
- Small Farmers Development Program (ADB/N)
- Poverty Alleviation Fund initiated by HMG/N
- National parks conservation programs
- Integrated rural development programs in Gorkha, Dhading, Kavre, Gulmi-Arghakhachi, Dang etc. (various donor agencies/INGOs)

On the other hand, a number of MSE promotion institutions exist with their involvement in multiple functional areas such as training in enterprise development, business management and skill training, credit facility, marketing linkages including trade fairs, exhibition, exposure visits, technology transfer, technical and business information dissemination, environment and quality control, counselling. Some of the successful initiatives of the government, non-government and private sector are listed here.

- Micro Enterprise Development Program (HMG/N/UNDP) in 10 districts
- Small and Micro Enterprise Development Program (FNCCI)
- Federation of Nepalese Cottage and Small Industries
- Enterprise development activities of IEDI
- Environment management (IEM)
- Small Industries Promotion Program (SIPP/Swisscontact)
- Marketing linkages of FTG, WEAN, HAN, TPC
- Agro Enterprise Center (FNCCI/USAID)
- Intensive Banking Program of commercial banks for CSI
- Women development programs like PCRW etc. under WDD
- Vocational and skill oriented training programs under CSIDB, DCSI, CTEVT, NGOs, private sector
- Rural development banks (Grameen Vikas Banks) in 5 development regions
- Micro-finance business by organizations: Nepal Environment and Pollution Eradication UNESCO Club, Kathmandu, the Society of Local Volunteers for Development Efforts (SOLVE Nepal), Dhankuta, and WEAN, Lalitpur

- Micro-finance development banks: DEPROSC, Chhimek, and Swabalamban development banks
- Self help groups, income generating schemes of various NGOs,
- Financial cooperatives, marketing cooperatives
- Commodity/trade associations
- District chambers of commerce and industry
- Homebased women workers network
- Private BDS providers

It is very difficult to separate micro-enterprise activity from activities taking place in the largely unorganised and informal sector of the country. For example, many activities of home-based workers, especially the women workers, are not visible at all. They are unaccounted for, but their work undergoes the input-process-output system that any micro enterprise undergoes. It therefore seems less relevant to 'own' any particular initiative of any specific institution that keeps these micro-enterprising activities going on. There would definitely be more organizations and unique modalities. What is important is that more and more gainful economic activities are generated and more people at low-income strata are engaged in such activities to improve their standard of living.

4. Micro Enterprise Development Program (MEDEP): An Ideal Programme for MSE Sector Development

Among the different approaches in practice, the MEDEP experience can be taken as an ideal model for MSE development and promotion in the country. With a stated goal of poverty reduction in rural areas, the holistic approach of MEDEP makes it stand clear above the rest as a model with integration of entrepreneurship development, credit, market promotion and follow-up services creating strong partnership among related organizations at the national and district levels. In its four years of starting, MEDEP has implemented programmes in 10 districts in all the five development regions.

MEDEP is targeted at two specific groups – low income families at the grassroots level (defined as families living on/below the poverty line, i.e., with per capita income of Rs. 6,090), and service delivery organizations at the national and district levels.

The major objectives of MEDEP are

- Poverty reduction of low-income families by sustainable micro-enterprise development
- Capacity building of micro-enterprise service delivery mechanism
- Facilitation of government policies and guidelines on micro-enterprise development

At the district level, MEDEP emphasizes on creating horizontal linkages and networking among local agencies concerned with service delivery in different components of micro-enterprise development. Thus, MEDEP has developed institutional partnership and coordination with various organizations such as the District Development Committee (DDC), Local Trust Fund Board (LTFB), Cottage and Small Industry Office/Board, district branch offices of Agriculture Development Bank (ADB/N), branch offices of Industrial Enterprise Development Institute (IEDI), District Chambers of Commerce (DCC), NGOs, cooperatives etc.

<u>Services</u>	<u>Partner organizations</u>
Skills training	DCSI, CSIDB, DCC
Market Promotion	FNCCI, FNCSI, GBC, Lotus Holding, WEAN Cooperative, NGOs
Micro-finance	ADB/N. LTFB, NGOs, Cooperatives
Entrepreneurship training	IEDI, CEBUD
Business counselling and follow up services	FNCCI, FNCSI, Commodity associations
Appropriate rural technology development	RECAST, SEACAW and other institutions
Micro-enterprise planning	DDC
Programme support services	LTBF

Best practices

A set of best practices has been identified based on its four years of programme experience, and these practices lend MEDEP the distinction of being unique and a workable approach of micro enterprise development in Nepal. Other micro enterprise development programs may benefit by adopting these best practices in a suitable manner.

The foremost strength of MEDEP lies in developing effective partnership and coordination among the service delivery organizations at national and district level for enterprise planning. The programme is implemented based on demand, i.e. through assessment of demand of people, market demand and resource potential of the particular area. Participants for MEDEP programs are selected through special selection criteria. Starting with entrepreneurship development training as an entry point, the selected participants are then provided with all necessary services in a well-designed sequence to enable them to engage in micro enterprise. MEDEP's strength also lies in continuous capacity building of its staffs, partners and beneficiaries, and its gender and group orientation.

Policy gap

The mid-term evaluation carried out by independent consultants in 2000 has pointed out that MEDEP has been successful in delivering the package of services through partnership approach and is effective in poverty reduction. However, it was observed that there are several policy gaps in the MSE sector and that it was necessary to address these gaps and formulate appropriate policy guidelines in micro-enterprises.

The major areas of policy gap highlighted by MEDEP are as follows:

- Institutional issues
 - a. No clear cut definition of micro-enterprises
 - b. No mechanism of coordination between line ministries and other agencies
 - c. Existing policy on forestry sector not favourable for micro-enterprise development
 - d. Institution for entrepreneurship awareness and development not addressing to MSE sector issues
 - e. Appropriate technologies not readily available for micro-enterprise development
 - f. Information centre lacking
 - g. No institution specialized for micro-enterprise

- Tariff and customs issues
 - a. No clear cut tariff system
 - b. Tax high for some goods and products needed for packaging
- Programme related issues
 - a. No policy for comprehensive package programme
 - b. Programmes mostly sectoral not addressing the problems of micro-enterprises
 - c. Most of the skills development programmes are supply driven
- Private sector role
 - a. Lack of involvement of private sector in MSE sector
 - b. Lack of market network and backward-forward linkages
 - c. Lack of concept on business development service in MSE sector

The secretary of Ministry of Finance, Dr. Bimal Koirala and the secretary of Ministry of Industry, Commerce and Supplies, Mr. Bhanu Acharya, both major players in policy reform regime regarding this sector, have endorsed the adoption of MEDEP modality in the micro-enterprise development and promotion in the country in the national seminar on micro-enterprise development held in Kathmandu in May 2002.

5. Policy makers' mindset trend on MSE development

Various policies and acts of the government related to the micro and small sector along with other relevant issues/activities that have bearing on micro enterprise development have been placed in distinct period-bound matrix vis-à-vis MSE policy issues – the Panchayat era (up to 1980s), the post restoration of democracy decade (1990s), and the beginning of the 21st century. This made it possible to make some form of trend analysis that gave a picture of changes in the mindset of the policy makers over a period of years regarding the development of micro enterprises in the country. The following issues are based on analysis of mainly those components covered in the Mindset Change Pattern for Reform given in Annex – 1.

Recognition of MSEs in economic development

1. The specific role of micro enterprises in the economic development has been recognized. Micro-enterprises are still considered as the smallest part of product-based manufacturing industries. A broad definition that incorporates the different value chain components of the micro-enterprises at the national level is still lacking. However, lately policy makers are faced with the urgency to have an integrated policy for this sector although they have come out with the new industrial policy, which still does not address a lot of issues inherent to this sector.
2. Micro-enterprises did not feature in the classification of industries although an oblique reference of it was made within the context of cottage industries. The industries were classified as cottage, small, medium and large scale. Cottage industry is a type of activity while others are scalar classifications. Confusion exists regarding the purpose of this classification. A distinction between micro-enterprises and cottage industries

has been attempted, but the mindset of the government is still regulatory and control rather than facilitation of the subsectors. The understanding that micro-enterprises can operate in urban areas and in the service sector is still lacking.

3. There is a liberal thinking regarding licensing and registration of micro-enterprises (read as cottage and small industries). Permission is not required for cottage industries and registration process has been deregulated and made simple. They may be registered within six months of operation.
4. The government is facilitating the cottage and small industries with a one-window system to provide all necessary facilities to industries. This sector has been reserved for Nepali nationals and transfer of technology is allowed for its development. There are liberal incentives such as exemption from taxes and duty draw back facilities for technology adaptation. The new Industrial Policy and the Tenth Plan envisage promotion of industrial villages for micro enterprises.

Supply/in-bound component

5. The forestry sector with the age-old adage “green forest Nepal’s wealth” has since long been recognized as one of the most important resources of Nepal. From the previous control of the government, private participation has been allowed in the creation, development and harnessing the gains from the forests. It is also seen as an important input source in the promotion of micro-enterprises. Forest resources, especially the processing of minor forest products is being promoted as potential source of employment generation and potential development of micro-enterprises.
6. Besides the participation of private sector and promoting local initiative in the development of forestry sector, the latter has incorporated wider scope for community development with the participation of different I/NGOs and donor agencies. Micro-enterprise development is invariably included as an integral part of this integrated development modality.

Processing component

7. The mindset of the government/policy makers is toward the protection of traditional and local resources and skill-based industries. Tax incentives have been provided and foreign investment is restricted in the traditional cottage industries. However, the micro-enterprises and industries having small capital are not well protected against the larger enterprises. Appropriate policies have not emerged to address this. The organized sector workers enjoy freedom of expression in the form of organizing and a number of other imperatives of social justice, which is slowly catching up with the informal sector workers.

Marketing/out-bound component

8. Special export processing zones for linking rural products with international markets envisaged. Strengthening of Haat bazaar, cooperatives, Fair Trade Group, market linkage (network) already incorporated in the policy, and MEDEP’s institutional partnerships for marketing as well as for other support services have received wide approval.

Micro-credit facilities

9. From government/parastatal organization sponsored micro-credit facilities, the private sectors in the form of financial institutions, cooperatives, development banks, and NGOs have been allowed in this area. This is partly in line to the liberalization mindset of the government since the 1980s decade.

Technology development/adaptation

10. There is a lot of emphasis on the promotion of alternative technology and local technology, and the government has provided for special incentives for the adaptation of technology to local needs and development of indigenous technology.

Role of local government and government pronouncements

11. The local governments have not been properly integrated in the development of MSE sector at local levels, although the policy makers are very keen on doing this. The VDCs and municipalities have been given the responsibility to facilitate cottage industries in their areas. MEDEP has laid a partnership strategy (including the VDCs and DDCs) to implement its micro-enterprise development programs. The government has fully endorsed the MEDEP modality as one of the means to achieve its poverty alleviation objective.

6. Major findings of current policy reform process

After reviewing various documents

1. Industrial Policy, 2002, which is in the final stage of being promulgated, has attempted to address micro-enterprises separately for the first time. However, the document has not come arrived at an agreeable definition of micro-enterprises. Confusion persists whether micro-enterprises should be defined in terms of number of employees or the amount of investment involved or in terms of their turnover. Or should it be a combination of all these. The government is wary that any facility allotted for the promotion of micro-enterprises may be enjoyed or misused by the medium or large enterprises instead. Such cases are evident in the hand knotted carpet manufacturing and handicraft subsectors, the agro-processing subsectors etc. Quantitative categorization poses problems. Should an enterprise having only four members of a family be categorized as micro-enterprise despite high investment or turnover? Should it be confined to only specific trades and activities? Fringe activities without scope of full employment and livelihood will not be sustainable. Limitation of investment or turnover will be counterproductive to the economic growth of the enterprise.
2. Micro-enterprise development is considered as an integral objective of the overall poverty alleviation endeavour of the government. This essentially means that micro-enterprise development is targetted to the rural poor population. However, another version of micro-enterprise is the term 'micro' meaning smallest of the small, i.e., very small enterprises, both rural and urban and irrespective of the economic status/level of the people involved. In the rural areas, micro enterprises are essentially family

businesses or self-employment in the form of specific trade like shoe making, craft, black smith, tailoring etc.

3. The issue of whether micro-enterprises should also be considered for their contribution to value addition in the trading subsector and other service industry also persists. Apart from the conventional thinking that micro-enterprises are related to manufacturing or production of certain goods primarily at the home/farm level, there is significant value addition taking place at various subsectors. Unfortunately, this issue has not been adequately addressed. It has been reported that on an average, MSEs generate as much as 40 percent value additions. Despite such significant contribution, MSE development is not seriously dealt with in a comprehensive package form.
4. The agriculture policy tends to concentrate more on the harvesting side, but this does not promote the development of MSEs, which should encompass both harvesting as well as the processing part. Hence, interlinking the agriculture policy with the industrial policy is very important to coordinate a comprehensive promotion of the MSE based on agriculture subsector. Agriculture and forestry are important subsectors that constitute the in-bound component in the value-chain of the MSE development. However, the existing forestry policy is not favourable for the development of micro enterprises. Coherence in the agriculture, forestry and social sector policies is required to address the issues of micro-enterprises. Besides the issue of policies, coordination between line ministries and other stakeholder agencies is also lacking.
5. MSEs are seen as very small or cottage enterprises in rural areas and there are no specific marketing policies or acceptable strategies as such to promote this subsector. The broader aspects of market linkages, product prices, basic market places and market promotion etc. are not clear. For example, strengthening the capacity of *haat* bazaars, other forms of market at the local level, marketing through specific channels, individual and cooperative form of marketing, commodity-wise marketing etc. are some issues that needs to be addressed for clarity. MSEs could establish strong markets by developing linkages with small and large enterprises. How is the demand and supply situation in the market to be assessed without proper information system in place that can provide appropriate information right at the district and village levels? The Ninth and Tenth Plan have both recommended linking up rural products with international markets by establishing export houses and export processing zones etc. However, these have not materialized as yet
6. Human resources development is an area that is over emphasized in all policies and in all sectors. Since long, it is being recognized as the prime mover for development in any field, and thus many institutions have been established to promote HRD in all sectors including the micro enterprise sector. However, proper institutionalisation to coordinate needs identification and developing specific skills is quite lacking. Human resource development should be demand driven rather than training for the sake of training. Rather than identifying and seeking to introduce new skills, the MSE policy should focus on the promotion of local skill based on social and cultural considerations as well as gender equity. Most MSE entrepreneurs cannot relate the benefit of HRD to their employees. On the other hand, there is more emphasis on skill training for self-employment and rather than on larger aspects of enterprise development.
7. Micro-credit policy for this sector is essentially seen as pro poor policy since this sector is closely linked to the poverty alleviation objective of the country's

development strategies. However, the result is that there is no direct reflection of micro credit flow in the economic mainstream. In essence, various commercial banks, the Agriculture Development Bank and other development banks including the Nepal Industrial Development Bank have implemented the credit policy in this sector. As per the intensive banking program of Nepal Rastra Bank initiated as far back as 1974, commercial banks are required to disburse 12 percent of their total loan portfolio to priority sector, potentially the micro enterprise sector. Likewise, a number of micro credits financial services of the rural development banks, cooperatives and, recently, NGO lending organizations have emerged under the Development Bank Act, 1995. Their main target is the micro enterprise sector. But loan disbursement, repayment procedures and interest rates vary by organizations, places and people. In many cases, the interest rates are out of context to market reality.

8. Registration of enterprises is vital for many reasons – for maintaining qualitative and quantitative information including their inventory, for monitoring and regulation of their activities, for administration of incentives and facilities for MSE promotion, for developing future strategies and so on. Registration entails formality of recording an enterprise at a certain level. The Industrial Enterprise Act entails a cottage industry to register within six months of its operation and registration is virtually open. Unlike for large enterprises, certain practical problems are associated in the registration of micro-enterprises since they are widely scattered all over the diverse ecological terrains of the country, encompasses virtually every subsector of the economy, and are mostly rural based, home based and at self-employment level. As mentioned earlier, there is no coordinated institutional machinery and specific policy to deal with this. However, recognizing the need to bring the MSE sector under some purview, policy makers are contemplating giving this responsibility to the local authorities like the VDC, municipality or DDC under the decentralization policy.
9. The Labour Act 1992 has provision for social protection of workers while the Industrial Enterprises Act requires that industries maintain certain environmental norms at the workplace and ensure occupational safety and health of workers are not infringed. These social protection and environment control regulations however cannot be strictly applied to MSE sector due to a number of reasons. Foremost, there is no institutional mechanism strictly devoted to the MSE sector, and a clear definition of micro enterprises does not exist. Without these two in place, it is likely that any strict policy and provisions to address these issues may deter the MSE promotion, while on the other hand, any exemptions from such regulation granted to this sector might be used/ misused by larger enterprises by way of benefiting from policy loopholes. With increased awareness and union activities, social justice in the form of social protection for workers is increasing. This has resulted in micro-enterprises having less competitive advantage against larger industries as well as cheaper Indian products.
10. The micro enterprise sector faces the brunt of liberalization and globalization of trade and business. Certain incentives on tariffs (although there is no clear cut tariff system) and technology adaptation are incorporated in the Industrial Policy to create a favourable environment for the development of this sector. However, as with any relaxation on tariffs and taxes and implementation of other special incentives and facilities, there is the fear of these being serving the larger enterprises due their overriding strength in all aspects. In fact, the policy makers and regulators of policies are faced with a very paradoxical situation. The growth and promotion of MSE sector requires creating favourable environment by allocating incentives and facilities in

virtually all subcomponents of an enterprise to ensure their competitiveness in the free market scenario. On the other hand, these have to be protected from the ever-keen interest of the larger enterprises to benefit from them. Larger enterprises have the capacity and strength to influence interpretation of regulations for their benefit, and if they do that, it defeats the very purpose of such incentives and facilities. The Decentralization Policy in Nepal may not fully empower the local governments to cope with such a situation.

It is thus apparent that a separate MSE policy dedicated to address the diverse concerns of this sector as discussed earlier in an integrated manner is very much required. The MEDEP with its demand driven strategies closely incorporated with strategies of sustainable enterprise partnerships and local capacity building provides a scope for micro enterprises in Nepal if a number of policy gaps are appropriately addressed. This program can then be safely replicated nation-wide.

Mindset Change Pattern for Reform

Major Policy Issues	The decade of 80s (Pre-democracy)	The decade of 90s (Post-democracy)	1 st decade of new century (Current position)	Mindset change trend
<p>Recognition for economic development (Classification, licensing and registration, etc.)</p>	<ul style="list-style-type: none"> • Micro enterprises may be referred <i>Cottage Industry</i> as “ Industries are labour intensive using local and traditional skills and having fixed assets up to Rs. 700,000 and sales turnover less than Rs. 25,00,000”. • Permission not necessary for cottage industries. • Registration at the Department of Cottage and Rural Industry. <i>Industrial Enterprise Act, 1981 and amendments, Art. 2,3 &5</i> • Permission to be taken from HMG for foreign investment in category of industries. <i>Foreign Investment and Technology Act, 1981, Art.3</i> 	<ul style="list-style-type: none"> • Prevent concentration of resources in any section of society, and preferential treatment and encouragement to national enterprises. <i>The Constitution of Nepal, 1990, Sec. 25.2</i> • Micro enterprises may be referred as <i>Cottage Industry</i>, which is traditional, labour intensive, which uses local skills and resources. Small enterprises are those having less than Rs. 30,000,000 as fixed assets. • Permission not necessary to establish any industries except those related to security, public health and environment. • Registration of cottage and small-scale industries at the Department of Cottage and Small Industries and its district level offices. The cottage industries can register within six months of its establishment. <i>Industrial Enterprise Act, 1992, Art. 2,4,59 & 10.4</i> 	<ul style="list-style-type: none"> • Cottage industries are traditional, labour intensive, which uses local skills and resources. • Micro enterprises employ less than 10 persons, use less than 5 KW power and invest less than Rs. 200,000 as fixed assets. • Small industries invest less than Rs. 30,000,000 as fixed assets. • Permission not necessary to establish any industries except those related to security, public health and environment. • Registration of micro enterprises at the <i>designated</i> department. • Industrial villages for promoting cottage and micro enterprises <i>Industrial Policy, 2002 (Draft), Sec. 7.2.1, 7.2.2, 7.2.3, 9.1, 10 and 13.1.6</i> 	<ul style="list-style-type: none"> • Some indication of distinguishing between cottage industry and micro-enterprise is coming up. However, there is still a lot of confusion regarding type of activities and scale of operation, while defining industries in the Industrial Policy. • Liberal thinking regarding licensing and registration is increasing. However, registration and recording is not yet coming out clearly. • Intent on reserving the sector for Nepali nationals. • Liberal incentives such as exemption from taxes and facilities for technology transfer.

<p>Supply/ inbound (agricultural and forestry based, mines, imports, etc.)</p>	<ul style="list-style-type: none"> • Two types of forest defined: (1) National forest- all forest lands as demarcated by the government including un-cultivated land, river, lakes and roads falling within its periphery. (2) Private forest: Lands and trees (other than fruits) owned by individual landholders. • Penalty for collection and transportation of forest products from national forest. • HMG, if necessary, may takeover the private forest. <i>Forest Act, 1962 and subsequent amendments, Sec. 2, 27 (Chha), 38</i> 	<ul style="list-style-type: none"> • One of the four long-term objectives of the Mater Plan for the Forestry Sector is “ to contribute to the growth of local and national economics by managing the forest resources and the forest based industries, and creating opportunities for income generation and employment”. • Out of 12 programmes identified in the master plan, one is “the medicinal and aromatic plants and other minor forest products” which aims to increase the supply of medicinal and aromatic plants and other minor forest products, and to facilitate their conservation into useful commodities and their distribution to local and foreign markets. <i>Master Plan for the Forestry Sector, Nepal, 1988 (Executive Summary)</i> • Cultivation and processing of herbs has to be strengthened. • Elementary processing should be introduced at the primary level where feasible; to reduce bulk carrying and allow producers to avail economic prices more readily. Some minor forest products have value addition potential at the primary level, as in the case of <i>lokta, sabai</i> grass, cane, bamboo, honey, etc. <i>Master Plan for the Forestry Sector, Nepal, 1988 (Main Report, Sec. 7.2.5 & 7.4.7)</i> 	<ul style="list-style-type: none"> • Introduction of programs such as: Environment and Forestry Enterprises (New Era/USAID) in 8 districts, Churia Forestry Development (GTZ) in 3 districts, Community Forestry Development (DANIDA) in 3 districts, Forestry Program for Livelihood (DFID) in 7 districts, Sindhu-Kavre Forestry Development (AUSAID) in 2 districts, Natural Resources Management Sector (DANIDA) in 17 districts <i>Economic Survey 2001/2002, MoF, Sec.</i> 	<ul style="list-style-type: none"> • Mindset toward promotion for forest resources for creating income generating opportunities including employment. • MSE development potential recognized in the forestry sector, especially in the processing of minor forestry products. • The age-old adage “Nepal’s wealth is its green forests” is extended to the promotion of micro-enterprises. • There has been a shift from government owned and controlled forests to increasing private sector’s role in forest creation, development and utilization of products. • Participation of N/INGOs and donor agencies in the integration of forestry sector with community development. MSE development seen as an integral part of this integrated development.
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<p>Processing (manufacturing, services, etc.)</p>	<ul style="list-style-type: none"> • Income tax holiday for 5 years for product based cottage industries. However, on consultation with the FNCCI, HMG may not provide this facility to some cottage industries. • No excise duty and sales tax for cottage industry <i>Industrial Enterprise Act, 1981 and amendments, Art. 10 (kha)</i> • Freedom of association not allowed in any form of establishments. <i>Nepal Factory and Factory Workers Act, 1959 and amendments</i> 	<ul style="list-style-type: none"> • No excise duty, sales tax and income tax for cottage industry. <i>Industrial Enterprise Act, 1992, Art. 15 (ka)</i> • For cottage industry only technology transfer allowed. <i>Foreign Investment and Technology Transfer Act, Art. 4.1</i> • Mandatory to follow the provision of appointment letter, limited working hours, minimum wages, public holiday, sick leaves and safety provisions to the workers even to establishments employing less than 10 persons. <i>The HMG directives dated 2049/12/17, based on the Labour Act, 1992</i> • Freedom of associations allowed to all workers even working in informal, small and agriculture sectors. <i>Trade Union Act, 1993 and amendments, Art. 3</i> • Micro Enterprise Development Program (MEDEP) implemented in a phase-wise manner in 10 districts with the technical and financial support of UNDP and MoICS/HMG. Its objective is to develop micro-entrepreneurs and creation of micro-enterprise service delivery mechanism that enables low-income families to achieve sustainable livelihoods based on local demand. Another objective is to formulate policies 	<ul style="list-style-type: none"> • No income tax, VAT and excise duty to cottage and micro enterprises. <i>Industrial Policy, 2002 (Draft), Sec.11.1, 11.2</i> • Foreign investment not allowed in some identified industries including cottage industries. <i>Foreign Investment Policy, 2002 (Draft), Sec.5.2 and Annex I</i> • Flexibility of workers with regards to numbers, security and wages. <i>Draft to amend the Labour Act, 2002</i> 	<ul style="list-style-type: none"> • The mindset is for the protection of traditional and local resource and skills based industries through tax incentives. • Foreign investment is still restricted in traditional cottage industries. However, technology transfer is allowed. • Despite special attention to the development of MSE sector, low capital industries or micro enterprises are not well protected against the economy of large scale industries. • Demand for more social justice for the workers is coming up irrespective of scale of operation of enterprises. • MEDEP implemented as an acceptable model for micro-enterprise development and for future replication in the country.
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		<p>on micro-enterprise development. Target at least 70% participation of women.</p> <p><i>MEDEP literature</i></p>		
Marketing/ outbound (micro-macro linkages, Cooperatives, retailing, exports, etc.)		<ul style="list-style-type: none"> • Implementation of various programs/ projects such as: Agro Enterprise Centre (AEC) by FNCCI/USAID MEDEP (HMG/UNDP): with emphasis on institutional partnerships for both domestic and international markets. 		<ul style="list-style-type: none"> • New modes of marketing and emphasis on marketing linkages/promotion through institutional linkages at local, national and international levels.
Human resource development (Skill training, entrepreneurship, trade unions, etc.)	<ul style="list-style-type: none"> • Vocational and skill oriented training programs under DCSI, CSIDB • TRUGA 	<ul style="list-style-type: none"> • TRUGA under DCSI later evolved into TRE (UNDP) • Ceramics Promotion Project (GTZ) • NGOs, training institutions • MEDEP (HMG/UNDP): entrepreneurship training 	<ul style="list-style-type: none"> • MEDEP (HMG/UNDP): entrepreneurship training • Special units in DSCI, CSIDB and IEDI for women entrepreneurship development and support micro enterprises through training programs. <p><i>Industrial Policy, 2002 (Draft), Sec.14.2</i></p>	<ul style="list-style-type: none"> • HRD has always been the area of emphasis although coordination of line ministries and relevant agencies has not been possible yet.
Credit facilities (banking, NGOs, etc.)	<ul style="list-style-type: none"> • Agricultural credit under the Small Farmers Development Program (SFDP) of ADB/N • Priority sector lending program of NRB viz Intensive Banking Program of commercial banks for MSEs 	<ul style="list-style-type: none"> • Development Bank Act, 1995 – limited bank services extended through cooperatives and NGOs • Rural development banks (Grameen Vikas Banks) in 5 development regions • Micro-finance business by 	<ul style="list-style-type: none"> • Micro-finance development banks: DEPROSC, Chhimek, and Swabalamban development banks • Poverty Alleviation Fund <p><i>Economic Survey 2001/2002, MoF/HMG, Sec. 4.7, 7.3</i></p>	<ul style="list-style-type: none"> • From government/parastatal sponsored micro credit programs, this sector has been made open for participation for private sector including NGOs, cooperatives, development banks etc.

	<ul style="list-style-type: none"> • Women development programs (PCRW) 	<p>organizations: Nepal Environment and Pollution Eradication UNESCO Club, Kathmandu, the Society of Local Volunteers for Development Efforts (SOLVE Nepal), Dhankuta, and WEAN, Lalitpur</p> <p><i>Economic Survey 2001/2002, MoF/HMG, Sec. 4.10, 4.13</i></p>		
Facilities for technology (development, transfer, etc.)		<ul style="list-style-type: none"> • Programs such as MEDEP (HMG/UNDP), ITDG Nepal etc. providing appropriate technology, alternative technology • Foreign investment is restricted in MSE sector <p><i>Foreign Investment and Technology Transfer Act,</i></p>		<ul style="list-style-type: none"> • Protection of traditional and local technology and promotion of appropriate/alternative technology.
Local self governance support and government pronouncements		<ul style="list-style-type: none"> • VDCs to facilitate implementation of cottage industries in their areas. • VDCs authorized to levy taxes on all commercial activities • Municipalities to facilitate implementation of cottage and other industries in their areas. <p><i>Local Self Governance Act, 1988</i></p> <ul style="list-style-type: none"> • Emphasis to be given to development and expansion of CSI and agro-industries to generate income and purchasing capacity of people by increasing opportunities for productive employment. • Institutional arrangement to be made to familiarize the CSI with market, technology, skills, etc. • Promotion of sub-contracting system for CSI to sub-contract 	<ul style="list-style-type: none"> • Endorsement of MEDEP modality as an appropriate model to be integrated in the national programs of poverty alleviation. <p><i>“Micro-enterprises for Poverty Alleviation” by Dr. Bimal Koirala, Secretary, MoF /HMG – a paper presented at the National Seminar on Micro-enterprise Development in Nepal jointly organized by MoICS and UNDP, 20 May 2002</i></p> <ul style="list-style-type: none"> • Recommendation of MEDEP model for micro-enterprise development in the mainstream national poverty alleviation programs <p><i>“Policy Needs in Micro-enterprises in Nepal” by Mr. Bhanu P. Acharya, Secretary,</i></p>	<ul style="list-style-type: none"> • Still no specific policies to promote MSEs although emphasis on CSI development is there. • MEDEP is fully endorsed as one of the strategies to achieve poverty alleviation objective of the nation.

		<p>work form large and MNCs.</p> <p><i>Eighth Plan, 1992 – 1997, National Planning Commission/HMGN</i></p> <ul style="list-style-type: none"> • Management and entrepreneurship training and credit facility for the promotion of micro-enterprises to create self-employment. • Expand CSI development bank activity through refinancing at concessional rates. • Appropriate technology and support for CSI development and promotion through integrated program <p><i>Ninth Plan, 1997 – 2002, National Planning Commission/HMGN</i></p> <ul style="list-style-type: none"> • MEDEP found to be well designed in a holistic mode with full integration of many partners that provide different services to micro enterprises. <p><i>MEDEP Mid-term Evaluation Report, 14 December 2000</i></p>	<p><i>MoICS /HMG – a paper presented at the National Seminar on Micro-enterprise Development in Nepal jointly organized by MoICS and UNDP, 20 May 2000</i></p> <ul style="list-style-type: none"> • Development and promotion of MSE to enhance employment through their financial and capacity strengthening. • Emphasis to be given to the development and promotion of micro-enterprises. For this, a package program with integration of appropriate technology, market, information, training and credit facilities will be implemented. • Separate policy and act to be formulated for MSE sector. • Enhance the entrepreneurship of rural women in food processing industry. <p><i>Concept paper of Tenth Plan, 2002 – 2005, National Planning Commission/HMGN</i></p>	
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List of policies and legislations that reflect the mindset of policy formulators regarding MSE sector

1. The Constitution of Nepal, 2047 (1990)
2. The Sixth 5 yr. Plan, 1980-1985
3. The Seventh 5 yr. Plan, 1985-1990
4. The Eighth 5 yr. Plan, 1992-1997
5. The Ninth 5 yr. Plan, 1997-2002
6. The Concept paper of Tenth 5 yr. Plan, 2002

7. The Industrial Policy, 1981
8. The Industrial Enterprise Act, 1981
9. The Industrial Policy, 1992
10. The Industrial Enterprise Act, 1992
11. The Foreign Investment and One Window Policy, 1992
12. The Foreign Investment and Technology Transfer Act, 1992
13. The Industrial Development Perspective Plan: Vision 2020, 2002 (Draft)
14. The Industrial Policy, 2002 (Draft)
15. The Foreign Investment Policy, 2002 (Draft)

16. The Factory and Factory Workers Act, 1959
17. The Labour Act, 1992
18. The Trade Union Act, 1993
19. The Labour Policy, 1996
20. The Labour Act, 2002 (Draft)

21. The Agriculture Perspective Plan, 1995
22. The Priorities and Strategic Framework of Agriculture Development, 199..

23. Master Plan of Forest Sector, 1988
24. Forest Policy, 1992
25. Forest Act,
26. Forest Act, 199..
27. Forest Act, 2002 (Draft)

28. National Policy on Science and Technology, 1990

29. Trade Policy,
30. Export Import Policy,
31. Budget Speech, 1989-90
32. Budget Speech 1990-91
33. Budget Speech, 2001-02

34. Food Act,

35. The Decentralization Policy,
36. The Local Self Governance Act, 1992
37. The Local Self Governance Act, 1998.