

# Options for Nepal's Economic Policies in the context of Global Economy<sup>1</sup>

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## The context

The global economy has increasingly been liberalized, at least on words. But there are still many restrictions on free movement of factors of production, mostly labor and capital. Stringent patent regulations make movement of technology really difficult. Much touted free trade regime is also full of non-tariff barriers, such as, environmental, labor and quality standards. And whenever national economic interests are at stake, even the most free market economies tend to put restrictions on imports. Big companies dump goods in developing countries at such a price that domestic industries find it hard to survive on the face of cheaper prices, which is oftentimes done at the behest of the exporting country government. There are, therefore, many aberrations to free market concept.

In spite of many barriers still existing, the liberalized global economy provides opportunities of growth for a country like Nepal. In addition, as Nepal is between two giant economies growing rapidly, there is a special opportunity available for the country. Nepal just needs to have right policies in place to reap advantage arising from close proximity with China and India.

## How Nepal interacts with the global economy?

Nepal's engagement with the global economy is through a variety of mechanisms, which can be jotted down as follows:

- **Trade in goods:** In 1975/76 total trade was Rs. 3,007 million of which 39.7 percent was export. In 2009/10, the total trade reached Rs. 436,555 million with only 14 percent share of exports (Rs. 316 billion of trade deficit). Nepal's international trade has grown exponentially. But it is contributing more to consumption than growth and capital formation.
- **Services:** Gross Receipts from services has risen from 693 million Rupees in 1974/75 to 30.56 billion Rupees in FY 52.83 billion in 2008/09.
- **Remittance:** This is through the exports of labor and since 1990 it is rising rapidly. In 1974/75 recorded remittance was just Rs. 203 million, which increased to 10.31 billion in 1989/99 and in the last fiscal year it was 231.73 billion. It has risen from 1 percent of GDP to now more than 20 percent of GDP.

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- **Tourism:** Accounts for less than 3 percent of GDP, but is one of the most promising economic sub-sector as it generates more employment than any other economic sub-sector.
- **Foreign Direct Investment:** Between 1990 and 1995, the growth was impressive, but has been dwindling since then
- **Foreign Aid:** Almost 30 percent of the annual government budget is financed by foreign aid.

### **Policy orientation for Nepal to be able to reap advantage from the global economy**

Nepal has 0.41 percent of the world population and is 43rd among 224 countries of the world. This is not a small market, but Nepal cannot and should not remain inward-looking. For a higher growth, we need to be outward-looking.

The economy is excessively dependent upon remittance, which is eroding productivity of the economy as young people in the highly productive age are working outside the country. Trade imbalance is increasing in an alarming rate, which is mostly financed through remittance. This is taking Nepal to a consumption economy, which needs to be changed. The major focus in the immediate future should be to correct the trade imbalance so that longer-term macro-economic stability can be achieved. A brief outline of the policy options in each of the above areas is presented below:

#### **Correcting trade imbalance**

The export growth strategy is good for the longer run, but for the short-run, to avert any foreign exchange crisis with already over-valued currency, the near-term strategy should be to go for import substitution and import rationalization. The approach should be, in order to near-term to longer-term, as follows.

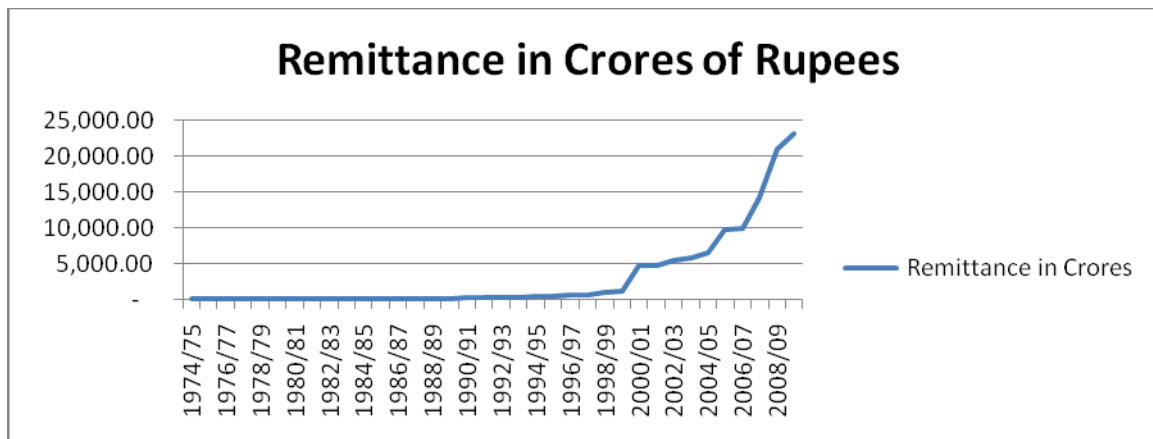
- Focus on core agricultural and livestock products that can, in a year or so, reduce imports. We can increase meat and milk products, fruits and vegetables by increasing small farmers' access to credit and technology. Nepal imported food and live animals to the tune of Rs. 30 billion in FY 2008/09. This has further increased in last fiscal year. This does not include informal import of live animals and meat from India and China. Based on the meat consumption and domestic production data analysis, it is estimated that Nepal has a deficit of about 15 billion worth of meat products alone, which is met through imports, both formal and informal. With enhanced attention to meat and milk products, Nepal can reduce imports. If we pay attention to quality and quantity, then there is a possibility of exporting both meat and milk products.
- Any tax or expenditure subsidy on imported products must be stopped so that real prices can push people to be rational consumers. This will help reduce import bill and correct trade imbalance. Petroleum is one glaring example.
- Invest in domestic energy generation.
- Promote processing of non-timber forestry products and cash crops, such as, tea, cardamom, ginger and coffee.
- Lobby hard to get away with unnecessary non-tariff barriers.
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### Expansion in services and tourism

Nepal has the potential of becoming financial hub of South Asia, as our banking industry is developing. But we need to improve our regulatory framework and institutions.

- Put in place good and credible anti-money laundering and controlling of terrorist financing laws and institutions. Nepal has the potential of becoming financial hub of South Asia, as our banking industry is developing.
- ICT industry is in a nascent stage, but there is a huge possibility in the context of qualified human resources.
- Nepal can become educational hub of South Asia. We need to encourage private sector to provide quality higher education.
- Focus of tourism should be Chinese and Indian market more than western world.

**Remittance:** We should not assume that this is going to grow in the future. The growth in remittance depicted below in a chart will flatten and then will decline soon.



Excessive dependence on this would inflict us with Dutch disease, because when this gets into crisis, there will be no other sector to compensate for the loss in the receipt of foreign exchange much needed for investments. There needs to be different strategy for the short-run and the longer run.

- Improving skill level of people wanting to go for foreign employment so that remittance receipts can be improved in the short-run.
- Creating better investment climate, so that young people take to entrepreneurship within the country. Political stability and assured right to property can help.
- Need to have flexible labor regime so that domestic industries can expand and absorb labor that would otherwise seek foreign employment.

### Foreign direct investment

As per the latest data, some 3 million Nepalese work abroad in foreign companies established in foreign land under the foreign labor laws. They are least secured. Had the same foreign companies been operating in Nepal, they would have been subjected to Nepali laws. The workers in such companies would have gotten the security of Nepali labor laws. The government would have gotten additional revenues for development

spending. There is absolutely no rationale for opposing foreign companies in Nepal. Yet, we do. The result is that we are pushing our young population to work in the most risky environments. In addition, if a foreign company operates in Nepal, there will be technology transfer and Nepali people can get middle to top level managerial jobs. Foreign investors find Nepal a politically risky country and their hopes are further dampened by administrative hassles. The approach, therefore, should be:

- Establish Investment Board with a view to providing one stop services to all foreign investors.
- Assure full security and insure that any losses they incur due to political risk will be compensated.
- Policy support to capital market development.
- Political propaganda against foreign companies must stop.

### **Foreign aid**

This is source of much of the government development spending, but at the same time this is also a source of trouble in some areas. One example, one donor agency recently suspended aid to a Nepali organization for calling Bandh. Foreign aid has also been used to fuel social discontent and unnecessary human rights while rights of the majority are totally ignored. Foreign aid is necessary, but government must have a better grip on it.

- Ensure that all aid is on-budget and aid to NGOs is given for national priorities and transparently.
- Emphasize aid on human and physical infrastructure creation.