

# NEPAL CASE STUDY FOR EUROPEAN REPORT ON DEVELOPMENT

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## Presentation outline

- Introduction
- Achieving development objectives: progress and constraints
- Future prospects and challenges
- Role of external actors in post-2015 development framework
  - Migration
  - Aid and finance
  - Trade and investment
  - Technology
- Policy recommendations

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## Introduction

This case study seeks to answer two clusters of questions:

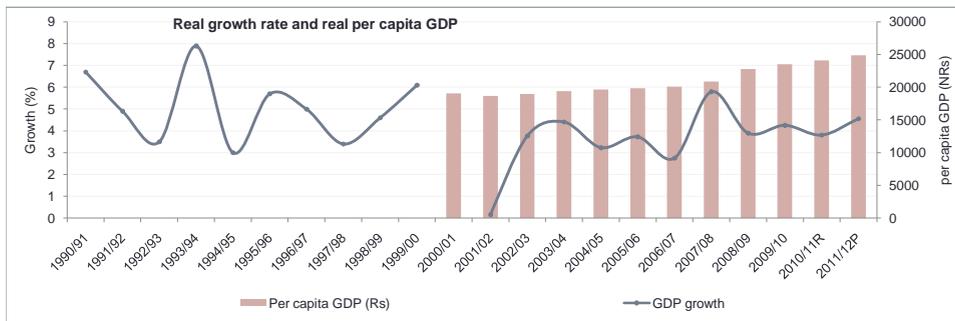
- Cluster I – State of play
  - How much progress has the country achieved since the 1990s?
  - What were the key drivers and obstacles leading to this?
  - What has been the role of external actors and impact of MDGs?
  
- Cluster II – Looking forward
  - What are the main constraints and opportunities facing the country?
  - What could external actors do to support national development strategies and how?

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Achieving development objectives  
Progress and constraints

## Economic progress

- Around 83 % of the population still lives in rural areas, down from 86.1 % in 2001
- Around 76.3 % of households depended on agriculture for living in 2010/11, slightly lower than 79.9 % in 2003/04.
- Contribution of agriculture and industry sectors to GDP is decreasing while that of services sector is increasing
- GDP growth rate has mostly been below 5% after 2000/01 (see Figure)



Source: Economic Survey 2012

## Social progress

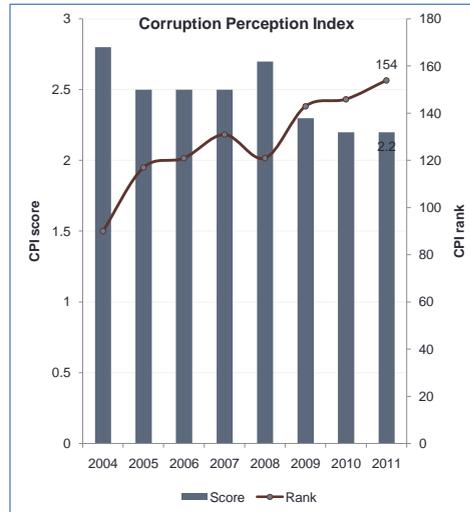
- Poverty and inequality – declined (see Table)
- Net enrollment rate increased to 93.7%
- Target for gender parity in enrolment for primary - already met
- Targets for infant mortality, maternal mortality, HIV and TB prevalence, and improved drinking water - projected to be met
- MDG targets on full employment and climate change – not likely to be met
- Huge resource gap in meeting MDG targets: Rs. 451 billion gap between projected cost and projected availability of financial resources between 2011 and 2015.

Declining Poverty and inequality in Nepal		
Year	Poverty (%)	Inequality (Gini)
2010/11	25.2*	32.94
2003/04	30.8	41.4
1995/96	41.8	32.2

Source: Nepal Living Standard Survey (1996; 2004; 2011)

## Governance

- Transparency International's Corruption Perception Index (CPI):
  - Corruption is either increasing (as shown by ranking) or has remained the same (as shown by score), especially after 2008.
  - In 2011, with a score 2.2, Nepal ranked 154 out of 182 countries in the CPI (see Figure).
- Worldwide Governance Indicators
  - Control of corruption indicator shows that the percentile rank of Nepal has nosedived from 60 in 1996 to 28.7 in 2010.
  - Rule of law indicator shows that Nepal's percentile rank has decreased from 50.2 in 1996 to 16.1 in 2010.



Source: Transparency International (various issues)

## Major drivers of and obstacles to progress

### Drivers

- Migration from rural to urban areas within the country
- Restoration of democracy and public awareness of devolution
- High inflow of remittances
- High share of foreign aid in meeting development expenditure
- Reasonably good growth in trade and investment in the initial periods

### Obstacles

- Growth constraints:
  - Inadequate supply of infrastructure (mainly power and road)
  - Neglect of agricultural sector
  - Lack of sound investment climate
  - Political instability and labor problems
  - Limited access to and high cost of finance
- Development constraints:
  - Low capital expenditure and domestic capital formation
  - Uncoordinated aid activities
  - Conflict and governance problem

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## Role of external actors

- Crucial role in financing development expenditure
- Not much impact on growth and employment generation
- Progress in social sector and awareness (some of it is also due to remittances and migration)
- Donor's focus shifted to social sector while the government's primary focus was infrastructure and directly growth-inducing factors
- MDG targets was adopted at national level and it guided development priorities, but not growth necessities

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## Future prospects and challenges

## Major Constraints

- Ongoing political unrest and instability
  - Intense factionalism has strained the possibilities of resolving key political issues and hindered long-term planning and institution of stable and inclusive democracy
- Weak/unfavorable investment climate and supply-side constraints
  - Private sector still not able to reap peace dividends
  - Poor infrastructure, inadequate labor skills and labor unrest, inefficient and unstable credit markets, and continued political instability
- Horizontal and spatial inequalities
  - Nepal considered one of the most unequal societies (but Gini coefficient decreased 41.4 in 2003/04 to 32.94 in 2010/11)
  - Spatial inequalities on the rise due to concentration of growth in urban areas
- Global financial crisis and its implications on development aid

## Opportunities for the Future

- Federalism and Decentralization
  - Shift from a centralized state to a federal republic
- Emerging Markets and the Rise of Global South
  - Rise of the global south, particularly India and China
- Potential to harness natural resources and markets
  - Interest among private sector, government and donors to harness Nepal's natural resource potential, particularly hydropower
- New modes of financing
  - Potential to benefit from new modes of financing such as the climate financing provisions in the 2010 – Cancun Agreements of the UNFCCC (United Nations Framework Convention on Climate Change)

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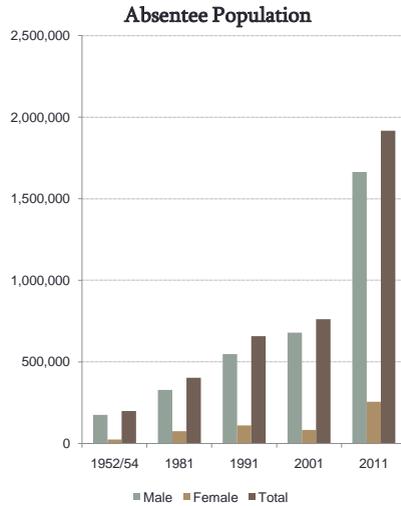
## Opportunities for the Future (Contd.)

- Improved human resource capabilities
  - Dividends from investment in human development (health and education)
- Capitalizing on remittances and migrant returnees
  - Appx. 56% of households in Nepal receive remittances
- Addressing information asymmetries
  - Proliferation of media and right to information leveraged to improve demand-side good governance

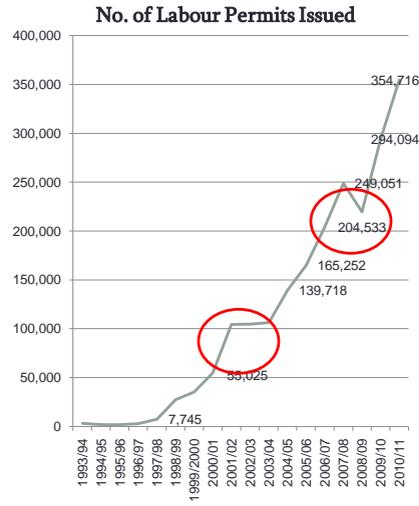
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# Migration

## Migration patterns and trends

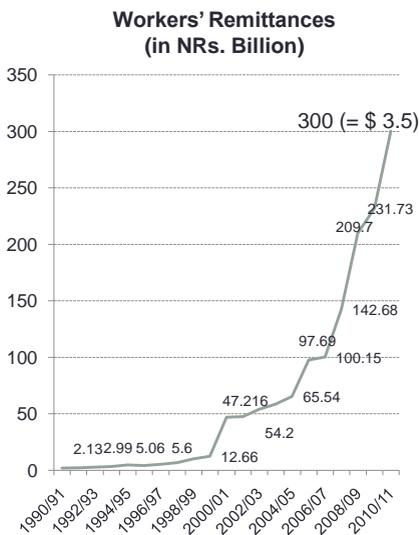


Source: Central Bureau of Statistics



Source: Department of Foreign Employment

## Consequences of migration



Source: Department of Foreign Employment; Ministry of Foreign Employment; and Nepal Rastra Bank

- 20.3 per cent of the total population is absent
- Every third household has at least one member working abroad
- More than 1,000 Nepalis go abroad every day
- More than half of the households (55.8%) receive remittances
- Remittance accounts for 20-25% of national GDP
- Remittance a major reason for the decrease in Nepal's poverty rate from 42% in 1996 to 26% in 2011

## Economic and social impacts

- **National economy**

- Economy susceptible to economic downturns
- Agriculture sector particularly affected by decrease in labour supply, reduction in production and increased wages
- Remittance euphoria leading to policy laxity
- Dutch Disease esp. in the absence of investment in productive sectors

- **Community/household economy**

- Change in sources of income
- Increased expenditure
- Newly acquired skills

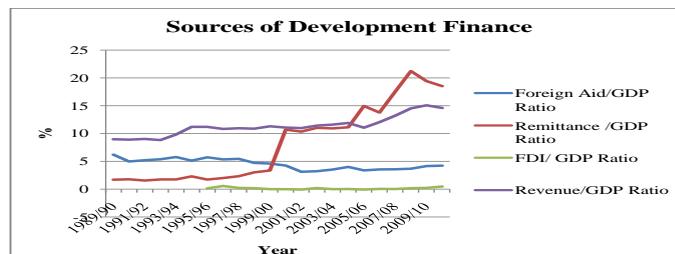
### Social effects

- On an average, 3 dead bodies per day arrive in Nepal
- Suicide leading cause of death amongst women of reproductive age
- Total fertility rate decreased
- Household responsibilities and decision-making transferred to women
- Breakdown in familial ties/relationships/broken families
- Decrease in social protection for elderly
- HIV problems increased (for India)

# Aid and Finance

## Major modes of financing

- Aid flows in relation to gross domestic output is declining
- Remittance flows, surpassing foreign aid and emerging as a major source of external capital flows
- Private capital flows in the form of foreign direct investment (FDI) has negligible role as a source of development finance
- Domestic resource mobilization, measured by revenue/ GDP ratio is increasing (see Figure below)
- There have been significant leakages through illicit capital flights (US \$ 7.9 billion during 1990 to 2008 (UNDP 2011)



Source: MoF 2012

## Salient features of foreign aid

- Increasing consistently in absolute value, but seems regime sensitive
- Finances more than half of development expenditure
- Share of bilateral aid increasing, but multilateral aid still dominates
- Loan gradually substituted by grants
- Role of non-traditional donors is increasing
- Directed mostly towards social sectors at the cost of productive sectors
- Wide gap between aid commitments and disbursement
- Played a catalytic role in the achievements in education and health sectors
- Positively impacted governance system, although concern of fiduciary risks by development partners indicates increasing corruption
- On the domestic front problems such as absorptive capacity, lack of need assessment, frequent change of officials and indifferences towards ownership persist

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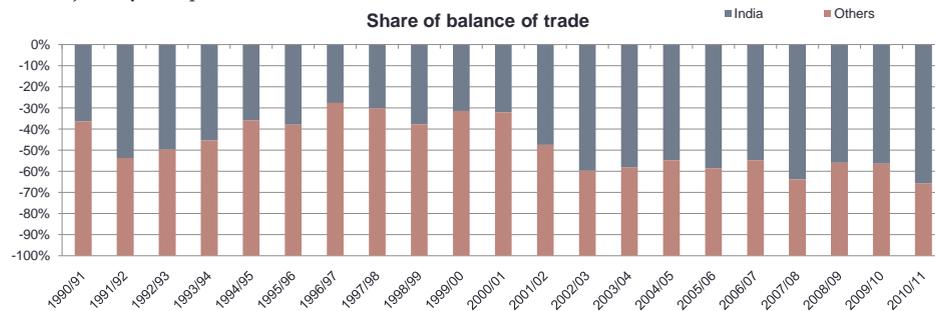
## Innovative instruments

- Sector-Wide Approach (SWAp) : health, education and local development sectors, but still one fourth of foreign aid in education and half in health is outside SWAp
  - Programme support : education, health, financial sector, local development, agriculture
  - TA pooling : Nepal Peace and Trust Fund
    - These initiative might have contributed to increased adherence to Paris Declaration but adversely affected institutional capacity on project identification, implementation and monitoring
    - As donors provide a large share of government revenue, the voice of donors, some time individual donor, carries considerable weight (case of education sector)
  - Foreign Employment Bond : Rs. 4 million in 2009/10 and Rs 3.4 million in 2010/11 were collected (less than 1 percent of the target)
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## Trade and investment

## Trade

- Imports increasing more rapidly than export resulting in unsustainable trade deficit (see Figure)
- India has been the most important trading partner of Nepal, 67 percent of exports and 66 percent of imports in 2010/11, up from 21 percent and 31 percent respectively in 1990/91
- Despite free trade with India and GSP facilities for exports to EU, export performance has been dismal due to several factors
- Major exports to EU are carpets, readymade garments, handicrafts, silver jewelry, and pashmina.



Source: Economic Survey 2012

## Export challenges

### Market access barriers

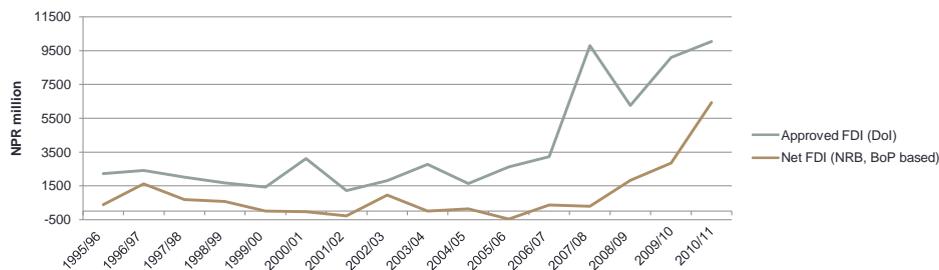
- Tariff barriers on certain products in some markets (e.g., US, South Asia)
- Other duties and charges
- Non-tariff barriers:
  - Quarantine in a non-transparent and discriminatory manner
  - Difficult customs procedures in India
  - Norway's refusal to import honey from Nepal due to absence of pesticide control programme
  - Subsidies to agricultural products provided by several OECD countries and India
  - Emerging NTBs such as private standards

### Supply side constraints

- Lack of infrastructure (power, road, warehouses)
- Lack of skilled human resources
- Low use of technology
- Limited access to finance
- Limited trade facilitation
- Political instability, strikes, and labour militancy
- Lack of proactive government support on product development and marketing

## Investment

- Nepal is the worst performer in South Asia (and one of the worst in the world) in FDI front. According to World Investment Report 2012, which ranks 182 countries, Nepal ranks 175th in inward FDI attraction index and 150th in inward FDI potential index
- Nepal managed to receive decent amount of foreign investment after the initiation of economic reform in 1991/92
- However, it remained erratic during the period of armed conflict
- Since 2006/07, FDI figures exhibited robust growth, barring 2008/09, during which it was affected by global financial crisis, although there is a huge difference between approved FDI and actual inflow (see Figure)



## Investment challenges

### Exploiting trade-investment nexus

- Trade preferences provided by China and other South Asian countries are hardly useful (relative to India)
- Problem in power trading
- Bordering Indian states now offer more hospitable climate including incentives for investments

### General investment climate

- Despite some progress, including operation of the Investment Board, investment climate is a major issue for foreign (as well as local) investors (IFC 2012)
  - political instability and power are the severe constraints
  - followed by Transport and corruption
- Legal problems
  - Some laws obsolete
  - Others contradict with each other
  - SEZ Act yet to be passed

# Technology

## Policy neglect?

### Current predicament

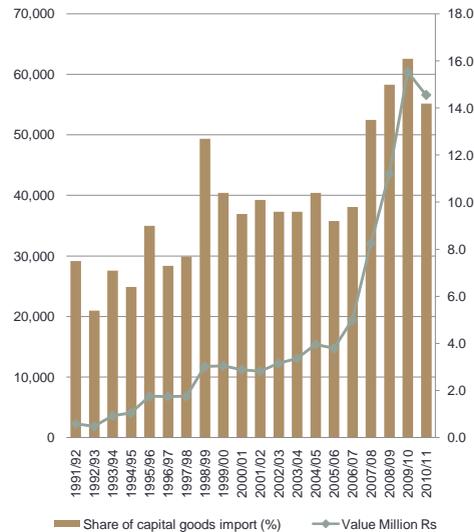
- Although technology contributes to MDGs, its role has been largely confined to ICT
  - Is it due to focus of MDGs on predominantly social goals?
  - Is it driven by commercial interest of select countries?
  - Is it simply a benign neglect?
- Despite some advances, Nepal remains a laggard
  - Lowest indicators in South Asia, e.g., 134/142 ranking on innovation compared to 38 and 42 for India and Sri Lanka respectively (WEF 2011)
  - IPR registration: Since the enactment of legislation in 1965, only 68 patents and 72 designs have been registered in Nepal

### Domestic constraints

- Budgetary
  - GERD 0.37% of GDP
- Human resource
- S&T graduates of reasonable size (24% of all graduates)
  - but brain drain is a major problem (worst in South Asia)
- Policy implementation gap
- Silo mentality of technology promoting institutions
- Limited involvement of private sector in R&D

## Technology transfer (TT)

- Traditional mechanism
  - Import of capital goods – relatively good (see Figure), but a few products like mobile phones have contributed to the recent surge
  - FDI – only 5% TT component
  - Some sectors have set good examples though
- Multilateral mechanism
  - Article 66.2 of the TRIPS Agreement has not moved beyond rhetoric
  - EU's role has been rather limited
- South-South technology transfer
  - Few successful examples (photovoltaic, threshing machine, high yielding seeds, tissue culture)
  - No formal mechanism, except for some climate and energy-related technology



Source: Trade and Export Promotion Centre

## Post-2015 agenda

## Migration

### Domestic level

- Migration should be choice not compulsion
- If migration unavoidable, protect the rights and welfare of migrants
- Emphasize implementation and enforcement of existing policy and institutional mechanisms
- Enhance local capacity through:
  - Increased budget and resources
  - Decentralization of roles and responsibilities
  - Improved capacity within government institutions
  - Strengthened role of civil society in monitoring of rules and regulations

### Regional/International level

- Promote initiatives/interventions that would help channel remittances into productive use
- Strengthen regional initiatives to secure rights & welfare of migrants
- Focus development aid in job creation, incl. utilizing skills of migrant returnees
- Strengthen vertical (local, national and international) and horizontal linkages (across sectors) while addressing migration related issues
- Identify migration as a development issue both in its economic as well as social/rights dimensions

## Aid and finance

### Domestic level

- Improve the system of governance and develop a strategy to tackle corruption
- Address the problems of
  - low absorptive capacity
  - lack of need assessment
  - frequent transfer of staff
  - lack of ownership

### International/regional level

- Development partnership should provide enabling environment, not intrude on policy space
- Continue numerical target ( e.g. 0.7 percent of GNI) and principles of Paris Declaration with credible milestones
- Set additional target for 'aid for trade' and 'climate finance'
- Set target of foreign aid in productive sectors (for example 40 percent of aid flows)
- Recognize that South-South/ Triangular cooperation is not substitute for traditional development assistance

## Trade and investment

### Domestic level

- Supply of electricity
- Good industrial relations
- Generating skilled labor force
- Upgrading production standard
- Technology generation
- Making laws trade and investment friendly
- Addressing major binding constraints on investment climate
- Expediting the passage of law and operation of special economic zones (SEZ)
- Matching incentives offered by Indian states bordering Nepal

### International/regional level

- Push for the early signing of SAARC Investment Promotion and Protection Agreement
- Resolve definitional complexity related to aid for trade
- Push for the inclusion of the following targets in the post-2015 development framework
  - Additional aid for trade should constitute at least  $x$  percent of ODA
  - Developed countries to source 1% of their total imports from LDCs
  - Developed countries to provide tax breaks to their enterprises to invest in LDCs

## Technology

### Domestic level

- Meet commitment to increase GERD to 1% of GDP
- Encourage S&T institutions – private sector collaboration
- Provide fiscal incentive to private sectors to invest in R&D/innovation
- Provide strong protection to IPR
- Create climate and offer incentives to prevent brain drain

### International/regional level

- Within the regional framework
  - Recognize technology as a cross-cutting issue
  - Expedite work on technology transfer beyond climate and energy
- In the post-2015 development framework
  - Recognize technology as a cross-cutting issues
  - Include specific targets on technology (going beyond ICT)
  - Include the provision of Article 66.2 of TRIPS and create a robust monitoring mechanism



Thank You