

Recent Policy Agenda in Nepal: Constraints to Growth

Bishwambher Pyakuryal, Ph.D.
Professor of Economics

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Crisis

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Introduction

- **Major events**

- Reinstating democracy in 1990;
- *Maoists' insurgency, 1996; peace accord, 2006; and*
- Declaration of *Federal Democratic Republican State* in 2008

- **Key policy agenda**

- Writing constitution based on new federal characteristics –the case for fiscal federalism
- Growth, equity and inclusion – diagnosing growth constraints & alternatives

Challenges

- **Immediate challenge**
 - Replacing unitary system of the government by the federal government structure (linking international federal practices with proposed model of fiscal federalism by Nepal's political parties)
- **Medium-term challenges**
 - If consensus is not achieved, the political discord among major parties will pose risk of an alternative conflict scenario

Challenges...Contd.

- **Long-term Challenges**

- Nurturing a thriving and inclusive democracy (growth w/equity) by safeguarding the interest of diversified groups (Census 2001 enumerated 103 distinct castes and ethnic groups including an “unidentified group” offering the lifestyle from Stone Age in far-west and hills to the jet age in capital) through strong and stable government is a challenge.
- In Argentina and Brazil, democracy strengthened the federal practices but weakened macroeconomic performances. In Nepal, democracy strengthened macroeconomic policy but increased income inequality (NLSS I & II, 1995-96 & 2003-04). Designing fiscal federalism is therefore, a challenge.

Federal Structure and Fiscal Policy

- Maoists have proposed 13 Autonomous Provinces based on ethnicity & backward regions – 3 tiers (Central, Autonomous federal provinces & Local governments)
- Nepali Congress proposes 7 Provinces (3 in the East; 3 in the West; & 1 at the Center) – Central, Provincial & Local governments where language & cast is eliminated
- CPN (UML) proposes 15 Provinces (Autonomous and Protected Zones within such provinces especially for ethnic & oppressed groups)

Federal Structure and Fiscal Policy.. Contd.

- Empirical findings from 32 large industrial and developing countries show that increased local government's spending and deficits leads to greater deficits at the national level.
- High-level technical competence is needed to make state divisions economically viable units.

Allocated amounts to different tiers

Table 1: Share of central and district level allocation and expenditure

Description	2007/08		2008/09		2009/10	
	Actual expenditure	Percent	Revised expenditure	Percent	Allocated expenditure	Percent
Total Expenditure	161,349,894	100.00	213,578,374	100.00	285,930,000	100.00
<u>Recurrent</u>	91,446,861	56.68	122,079,524	57.16	160,632,361	<u>56.18</u>
Central	82,771,432	51.30	109,292,422	51.17	138,526,229	48.45
District	8,675,429	5.38	12,787,102	5.99	22,106,132	7.73
<u>Capital</u>	53,516,101	33.17	73,309,549	34.32	106,284,793	<u>37.17</u>
Central	40,993,418	25.41	52,118,666	24.40	77,409,591	27.07
District	12,522,683	7.76	21,190,883	9.92	28,875,202	10.10
Debt repayment	16,386,932	10.16	18,189,301	8.52	19,012,846	6.65
Total Central	123,764,850	76.71	161,411,088	75.57	215,935,820	75.52
Total District	21,198,112	13.14	33,977,985	15.91	50,981,334	17.83

Source: Red Book, fiscal year 2009/10, Ministry of Finance, Government of Nepal

Federal Structure and Fiscal Policy (contd...)

- Internal revenue of FY 2001/2 - 2004/05 reveals that share of internal revenue from local bodies in GDP is just 0.4%. In total national income, it is only 3.22%.
- In [Mountain region](#), contribution of internal sources is 8.56% of the grant and 7.89% of the total income. In the Hilly region and Terai, these figures are 23.96% and 19.33% and 53.92% and 35.11% respectively.
- [Nepal's 24 development](#) districts (32%) make revenue less than 5% of their total expenditure and 60% districts (45 districts) generate less than 10% of their total expenditure.
- This shows the highly centralized financial system of the country, which has contributed to the increasing dependency of the local bodies to the Central government.

Growth, Equity, & Inclusion

- [GDP growth](#) is lowest in the region. Although poverty between 1995-2003 declined from 42 percent to 31 percent, the Gini Coefficient rose from 0.38 to 0.47
- Growth Diagnostic study (2009) states, major constraint to inclusive growth are:
 - [Poor governance](#) & institutional Mechanism
 - Lack of [infrastructure](#) ([transportation](#), [electricity](#), irrigation)
 - Lack of Productive employment opportunities
 - Inadequate and weak public service delivery
 - Weak human capabilities & unequal opportunities
 - [Political instability](#)
 - **Inadequate social safety nets:** Nepal lies in 24th position among 31 countries in Social Protection Index Ranking. Nepal's social protection expenditure as a percentage of GDP is only 2.3 in comparison to 4.0 percent of India, 5.3 percent of Bangladesh and 5.7 percent of Sri Lanka
 - Exclusion

Conclusion

- The latest **Enterprise Surveys** (2009) identifies corruption, customs and trade & labor regulations as major constraints to investment and doing business.
- With regards to Nepal's overall Ease of **Doing Business** ranking, it costs twice as much to start a business and nearly twice as long to obtain a construction permit as the regional averages.
- **Index of Economic Freedom**-Nepal's overall score declines in four out of the 10 economic freedoms. However, it still scores relatively high in fiscal freedom, government size, and monetary freedom.

Conclusion (Contd.)

- Food price inflation, access to credit, timely availability of fertilizer and uninterrupted power supply (linked to overall agriculture performance but since it has not been reflected in election manifesto categorically, there is little public support).

Conclusion Contd.

- Government capacity weak & overstretched – failing macroeconomic management and higher recurrent expenses
- Challenges in regulating & managing militant groups from political parties
- Madesh militancy – 30% population w/industrial & agricultural resources – issues of rights, citizenship, diversion of power
- Status-quo in managing trade union militancy – poor labor relations, anti-business ideology
- The political economy is gloomy through policy instability, crime, extortion and consequent insecurity

Thankyou

Allocated amounts to different tiers

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Source: Red Book, fiscal year 2009/10, Ministry of Finance, Government of Nepal

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The share of Internal Source in total grant, and total income

Rs. in, 000

Internal Sources	Mountain region (16 districts)	Hilly region (39 districts)	Terai districts (20 Districts)Total	Total
Internal Sources	39763	346332	457941	844036
Administrative Grant	91152	241793	128130	461075
Development Grant	372848	1203952	721133	2297933
Total Grant	464000	1445745	849263	2759008
Total Income	503763	1792077	1307204	3603044
Internal Sources as % of Total Grant	8.56	23.95	53.92	30.59
Internal Sources as % of Total Income	7.89	19.33	35.11	23.43
Total Grant as % of Total Income	92.11	80.67	64.97	76.57

Source: Income and Expenditure Report, 2007 ADDCN

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Contribution of Revenue in Net Expenditure

Development Region	Revenue is less than 5% of the net expenditure		Revenue is between 5 – 10% of the net expenditure		Revenue is less than 10% of the net expenditure		Total Districts	
	Districts	% of total districts	Districts	% of total districts	Districts	% of total Districts	Districts	% of total districts
Eastern	1	6.25	8	50	9	56.25	16	100
Central	3	15.79	3	15.79	6	31.58	19	100
Western	2	12.50	8	50	10	62.50	16	100
Mid Western	12	80	1	6.67	13	86.67	15	100
Far Western	6	66.67	1	11.11	7	77.78	9	100
Nepal	24	32.00	21	28.00	45	60.00	75	100

Source: Pyakuryal et. Al (2009)

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South Asia in Global Infrastructure Rankings: RIS Index

Countries	1991		2000		2005	
	Index	Rank	Index	Rank	Index	Rank
India	3.48	50	3.95	49	4.49	51
Sri Lanka	2.57	62	3.18	56	4.35	53
Pakistan	2.39	64	2.26	68	2.89	66
Bangladesh	1.83	73	2.12	71	2.5	74
Nepal	1.29	81	1.37	81	1.38	86

Source: RIS,2008

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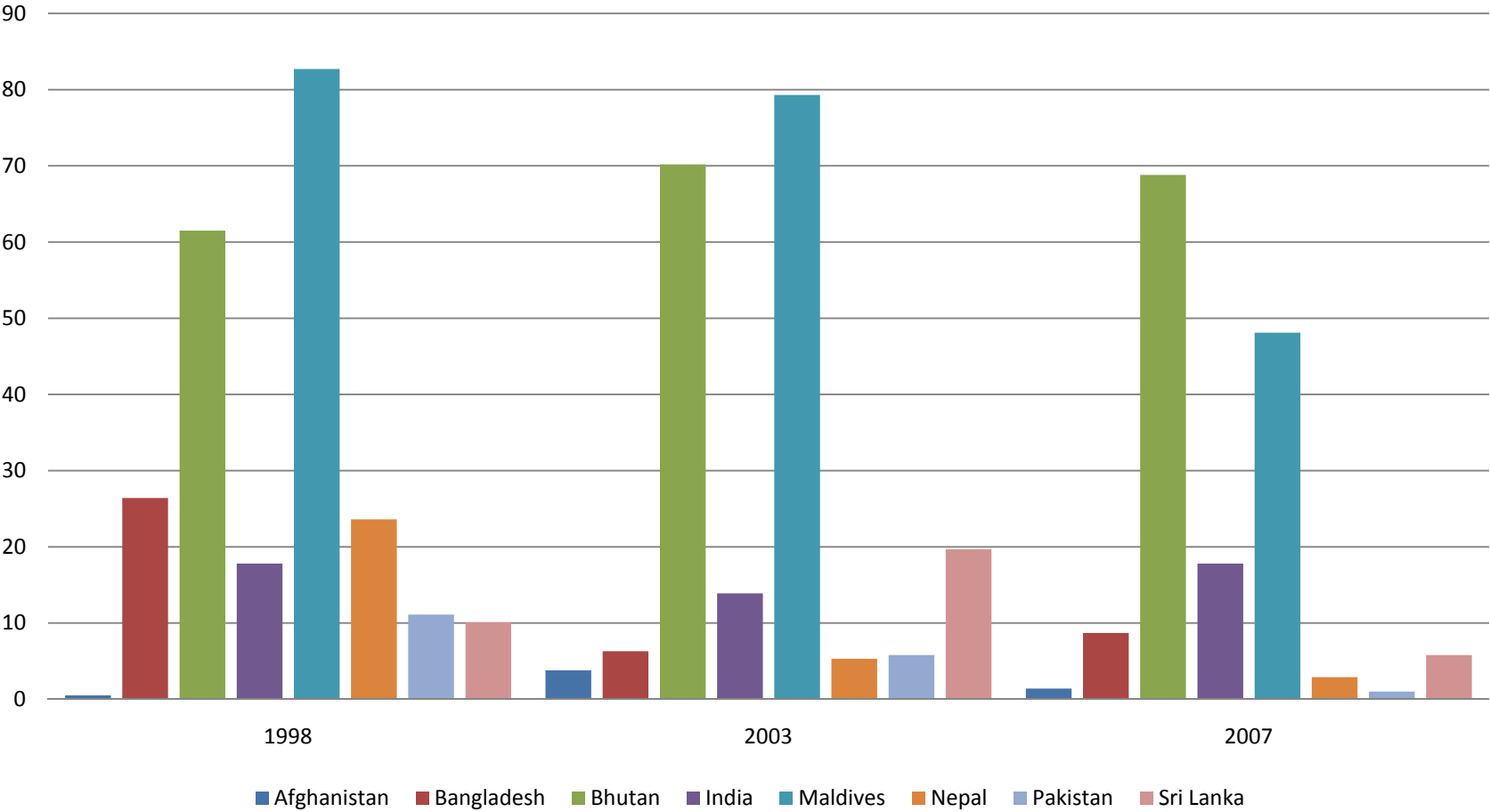
Governance Indicators for Nepal, Percentile Rank (0-100)

Governance Indicators	1996	1998	2000	2003	2004	2005	2006	2007	Regional Average	
									1996	2007
Voice and Accountability	46.4	42.3	43.3	25.5	18.3	13.9	15.4	22.6	29.5	28
Political Stability	26.9	23.6	14.4	5.3	2.9	1.4	2.9	2.9	25.3	19.3
Government Effectiveness	36	36	40.8	34.1	22.3	15.2	21.8	21.8	45.4	36.5
Regulatory Quality	22.9	31.7	28.3	33.2	31.2	25.9	26.3	26.7	43.3	31.9
Rule of Law	51.4	52.9	44.8	37.1	32.4	23.8	33.3	31	33.9	38.3
Control of Corruption	44.2	42.7	40.3	51	33	28.2	29.6	30.4	35.2	33.9

Source:WDI

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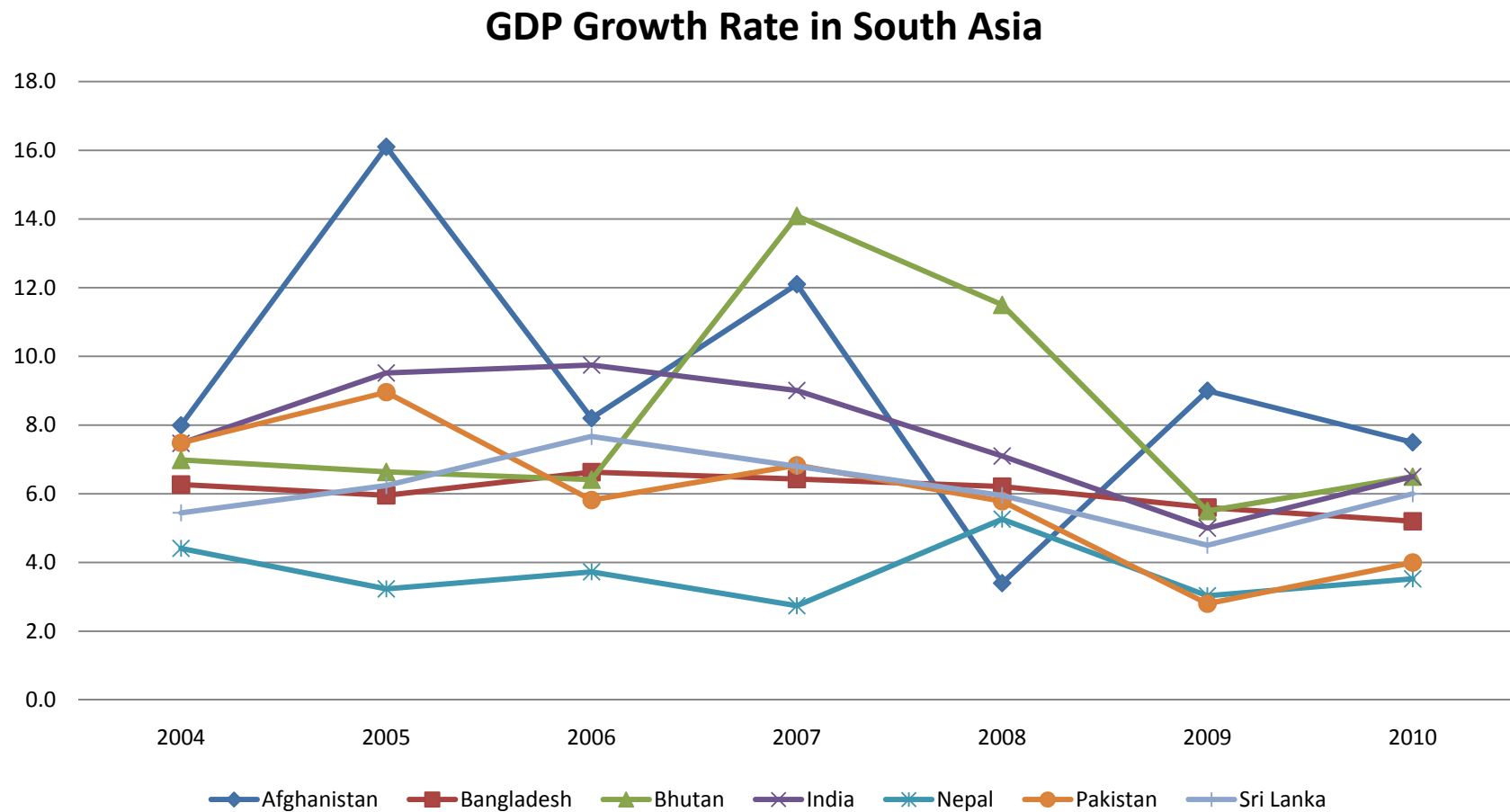
Comparing Political Stability in South Asia (percentile ranks)



Source: World Governance indicator

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GDP Growth Rate in South Asia

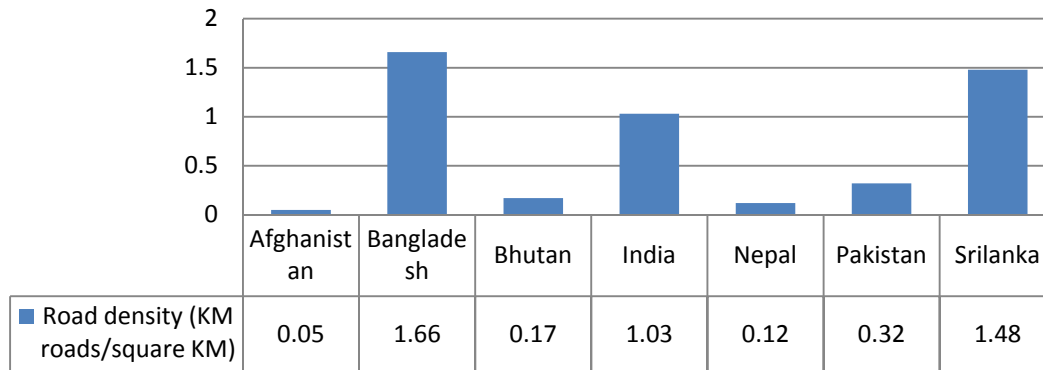


Source: ADB Outlook (2009)

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Road Density in South Asian Countries

Road density (KM roads/square KM)

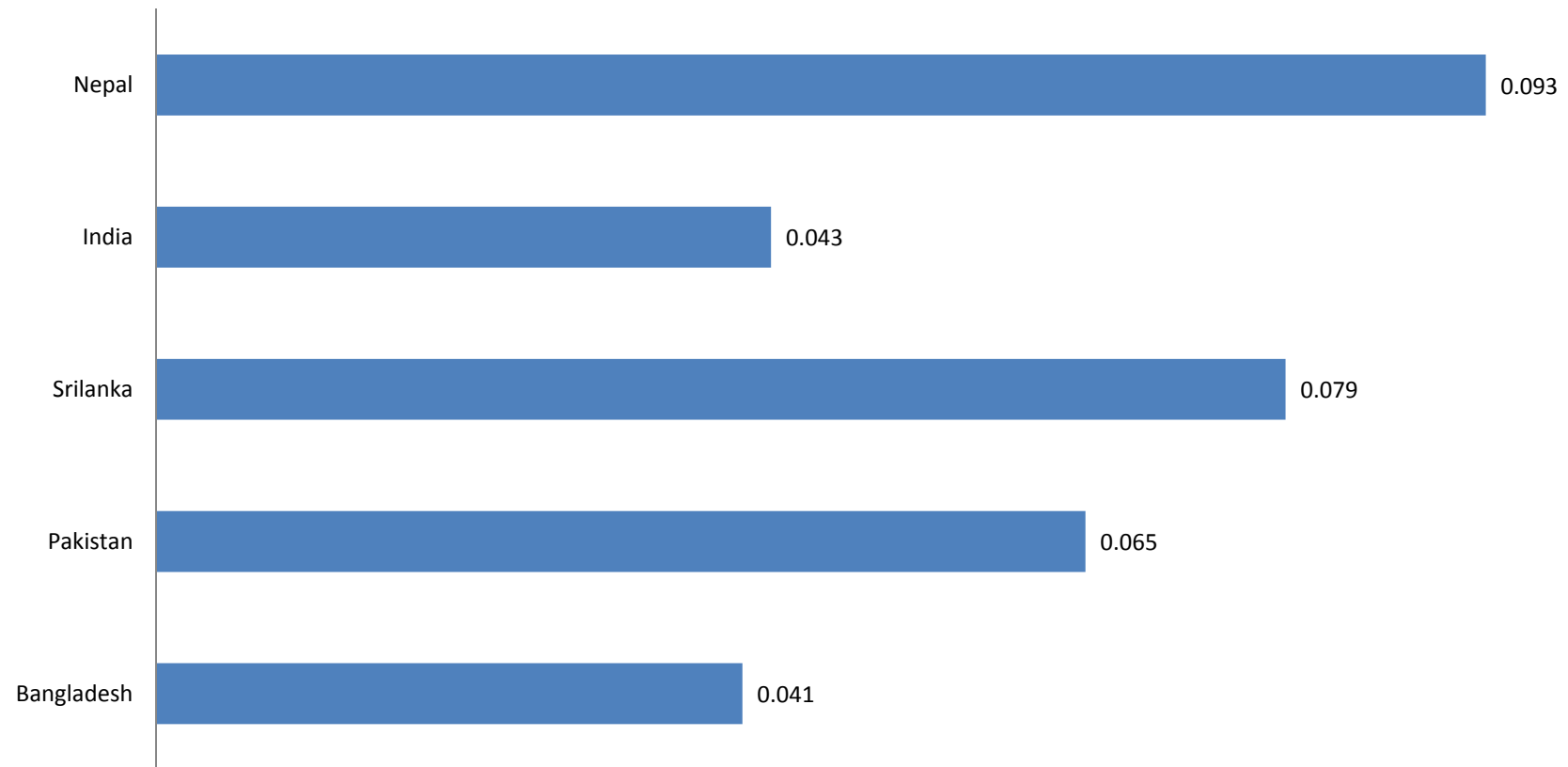


Region	Total Length of Roads (Km)	Population Influenced Per Km. of Road (Nos.)	Road Density (Km./100 sq.Km)
Eastern	3481	1535	12
Central	6665	1205	25
Western	2955	1547	10
Mid Western	2215	1360	5
Far Western	1518	1444	8

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Comparative Electricity Tariff in South Asia

Electricity Tariff (\$ KWh,2000)



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Comparison of Labor-Related regulations with Other South Asian Countries

	Difficulty of hiring index	Rigidity of hours index	Difficulty of firing index	Rigidity of employment index	Non-wage labor cost (% of salary)	Firing Costs (weeks of wages)
Afghanistan	0	40	30	23	0	0
Bangladesh	44	20	40	35	0	104
Bhutan	0	0	20	7	1	10
India	0	20	70	30	17	56
Maldives	0	0	0	0	0	9
Nepal	67	20	70	52	10	90
Pakistan	78	20	30	43	11	90
Sri Lanka	0	20	60	27	15	169

Source: Doing Business Report

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