

IIDS Special Edition

Selected Essays on Nepali Economy

Edited by

BISHNU DEV PANT, PhD

NAYAN KRISHNA JOSHI, PhD

PRAMOD RIJAL



INSTITUTE FOR INTEGRATED DEVELOPMENT STUDIES
at
KATHMANDU UNIVERSITY

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Publisher

Institute for Integrated Development Studies at Kathmandu University
Post Box 2254, Kathmandu, Nepal
Telephone: 977-1-4371006, 4378831
Email: info@iids.org.np
Website: www.iids.org.np
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Recommended Citation

Institute for Integrated Development Studies at Kathmandu University. (2017). *Nepal Economic Outlook Special Edition: Selected Essays on Nepali Economy*. Kathmandu: Institute for Integrated Development Studies at Kathmandu University.

Printing

Sopan Press, Dillizabar, Kathmandu

Price

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ACKNOWLEDGEMENTS

This special edition volume is an effort to build a greater understanding of Nepali economy by bringing together experts from Nepal and beyond. The publication of book in this form would not have been possible without the help from a lot of individuals and institutions. Institute for Integrated Development Studies at Kathmandu University highly acknowledges the effort taken by the contributors and the editors in bringing out this publication.

I would like to thank Dr. Bishnu Dev Pant, Dr. Swarnim Wagle, Dr. Sailesh Tiwari, Dr. Satis C. Devkota, Dr. Mukti P. Upadhaya, Dr. Krishna P. Sharma, Dr. Khem R. Dahal, Dr. Prem Jung Thapa, Dr. Ramesh Paudel, Dr. Dileep K. Adhikary, Mr. Vidyadhar Mallik, Dr. Kamal P. Upadhyaya, Dr. Mahendra P. Lama, Dr. Christopher Butler, Dr. Bishwo Poudel, Mr. Pramod Rijal, Ms. Shailie Rimal and the team of editors: Dr. Bishnu Dev Pant, Dr. Nayan Krishna Joshi, and Pramod Rijal for their contribution. I am equally grateful to language editors Mr. Ajaya Bhadra Khanal and Mr. Shubhanga Pandey. Similarly, the publication of book would not have been possible without the continuous guidance and support from the Governing Council members of IIDS.

I would also like to thank Mr. Govinda Ghimire for layout and cover design. I am grateful to all people who have helped directly and indirectly in bringing out this volume. Last but not the least, a very special thank you goes to the entire IIDS team members for lending out every kind of support needed.

Mohan Man Sainju, PhD
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IIDS Special Edition
June 2017

FOREWORD*

Nepal today is a country in a hurry. Building on the dramatic political achievements of recent years of expanding democratic freedoms and increasingly inclusive polity, Nepal now seeks to leapfrog in terms of development, harnessing its unexploited economic assets, consolidating social gains, and minimising location-specific vulnerabilities. Essays in this compendium are a welcome addition to enriching contemporary discourse on facilitating social mobility and inclusion, accelerating economic reforms, and deepening regional collaboration for shared progress.

Nepalis and their economy are innately resilient. Even when the earthquakes of 2015 devastated parts of the country, our GDP growth rate did not nosedive. It took a bigger blow, the Blockade, to grind it to a halt in 2016. This year, we have rebounded to a healthy growth of 7%, thanks to a shrunk base, good monsoons, steady electricity supply, and normalisation of trade. Our focus now should be on continuing on a high growth path of at least 7%, year after year. This will double the size of our economy in 10 years and make us a vibrant, enterprise-friendly, middle-income nation by 2030.

The priority now should be on job-creating economic change, propelled by large investments in infrastructure. Energy and connectivity can unleash potentials in manufacturing, tourism and agriculture. There are major irrigation projects, which, when complete, will be like having a good monsoon every year. Sustained rise in agricultural productivity will form a durable basis of high and inclusive growth for decades to come.

After a gap of nearly 20 years, elected local governments are being formed in the grassroots with great enthusiasm. The 2017 budget has made a transformative departure by transferring hundreds of billions of rupees to local government coffers. Like an Englishman's home is his castle, parts of Singha Durbar will now be located in every Nepali village. This will redress our deficits in governance, public-service provisioning and lackluster rural growth. This is, however, conditional on local governments being functional. While the urban municipalities are better equipped, villages will need to be guided. Transitional handholding cannot be paternalistic because each local government is sovereign.

Implementation of federalism frees public bodies like the National Planning Commission and other think tanks to take the long view. This begins with Vision 2030 that articulates the sources of long-term prosperity. Going forward, we must nurture the following five Ds to form our tailwind of progress:

Distance: Our proximity to two of the world's fastest-growing economies, and half the world living within five hours of flying distance, is a huge resource. With links forged with China's One Belt and Road Initiative and India's drive to connect its Gangetic hinterlands, we can reverse the effects of the 20th-century handicap imposed by our landlockedness. With lower costs of engagement, we can be part

of international production networks, attracting FDI, and specialising in components where we have an edge.

Demography: Our greatest strength is our people, half of whom are aged below 22. After 2028 we will become an ageing society, and after 2054, an aged one. We have a narrow window left to reap the demographic dividend, and to make up for two slow decades.

Democracy: There is no better way than democracy to govern a heterogeneous society like ours. But we need to revamp the way we celebrate and leverage democracy: it is not just about periodic elections; it has to evolve into a culture of rules-based governance that aggregates and responds to our diverse preferences. Without proper checks, federalism could go horribly wrong, transporting problems of Kathmandu to local units and amplifying them.

Digitisation: Our old model of trade and production is obsolete; we need to catch up by leapfrogging into the digital age of fragmented production across integrated economies. There is an advantage inherent in backwardness: 25 years ago, there were 71,560 phones in the entire country, today Nepalis carry 28 million cell phones.

Diaspora: Our diaspora is coming of age. They need to be courted as the first investors. They must be our emissaries for greater trade, investment and tourism, stronger socio-cultural ties and firmer academic exchange and transfer of knowledge.

Issues covered in this volume are helpful to frame a forward-looking vision of Nepal's prospects. The wide span and eclecticism of topics reflects both the versatility of development challenges in a low-income country and the complex, interwoven linkages across sectors. I trust that this volume will have practical policy resonance, and shall be of interest to not just the policy makers, academics and journalists, but also a lay audience concerned about our country's fortunes.

Swarnim Waglé, PhD

Member

National Planning Commission

Kathmandu, Nepal

*This foreword draws in part on his guest editorial published in Nepali Times of June 8, 2017.

INTRODUCTION

Nepal expects to graduate from the UN-defined status of a Least Developed Country by 2022, and achieve most of the Sustainable Development Goals by 2030, becoming by then a middle-income nation. This special edition of IIDS focuses on key contemporary issues facing the country with these medium term ambitions in sight. Essays in this volume are grouped into three core areas: social mobility, inclusion and protection (Part I); economic policy reforms (Part II); and cross-border cooperation in energy and water (Part III).

Part I includes five chapters on poverty, health and agriculture. Sailesh Tiwari (Chapter 1) suggests policy areas that could help Nepal consolidate the gains made so far on improving living standards and reducing poverty. These include equalising opportunities, reducing vulnerabilities, and enhancing productivity. Satis C. Devkota and Mukti P. Upadhyay (Chapter 2) examine the source of differences in the use of institutional healthcare by women, during pregnancy and childbirth. Using the 1996 and 2004 Nepal Living Standard Surveys, they find that inadequate access to a health center, hindered by costly transport, accounts for more of the difference in the use of the healthcare across development regions and across ecological belts and less so across ethnic groups. The third chapter, by Bishnu D. Pant, Shailie Rimal, and Pramod Rijal, deals with malnutrition in Nepal. They describe current government policies and programs to address malnutrition, and suggest four possible ways to improve it: a) ensuring national and household level food security; b) stabilising food prices; c) improving rural infrastructure; and d) focusing on maternal nutrition.

Krishna P. Sharma and Khem R. Dahal (Chapter 4) argue that Nepal has not realised its potential in agricultural productivity despite past development efforts and existing agro-ecological, biophysical, and ethnocultural wealth. They argue that the 20-year Agriculture Development Strategy, that the government recently formulated based on the experiences of the past 20-year Agriculture Perspective Plan (1995-2015), has some limitations, and that there is a need for a tangible paradigmatic shift in theory and practice of agriculture. Among others, this requires a renewed emphasis on healthy living soil, investment in social health, farmers' varieties and local seed diversity, incorporating and prioritising organic agriculture research in national research framework.

The final chapter in Part I, by Prem Jung Thapa, surveys the role of the government during the period of crises such as the April 2015 Nepal Earthquake and the Blockade of November 2015. He argues that the government should play the role of facilitator of market-oriented approaches and risk manager during crises. As a facilitator, it should explore innovative ways to create economic incentives to attract the private sector to aid reconstruction. As a risk manager, it should follow the income-contingent repayment schemes to manage an appropriate distribution of risks between the private and public sectors.

Part II contains four essays on trade, foreign direct investment, and tax reform. Ramesh Paudel and Swarnim Waglé (Chapter 6) assess Nepal's bilateral export performance vis-à-vis its active export destinations using data on bilateral

exports with at least 134 partners, averaged over a three-year period between 2009 and 2011. Employing a novel gravity modelling framework that accounts for country selection bias and firm heterogeneity bias, they document that structural factors such as geographical and cultural proximity matter more than policy barriers imposed by destination markets. They also identify countries to which Nepal “under-exports” and those to which it “over-exports” and suggest that exports could be deepened and diversified. Dileep K. Adhikary (Chapter 7) also analyses the state of Nepal’s exports based on economic composites and interactions with stakeholders in the private and government sectors. He argues that exports, which were growing in the past, succumbed to political conflicts in recent years. He suggests that proper political management and export integration are required to sustain economic growth. Vidyadhar Mallik (Chapter 8) reviews some recent trends in tax reforms and suggests ways to deepen and contextualise them.

Kamal P. Upadhyaya and Pramod Rijal present issues surrounding the inflow of foreign direct investment (FDI) in Nepal in Chapter 9. The authors argue that Nepal has not been able to attract significant amounts of FDI because of political and economic risks. They suggest that Nepal needs to mitigate these risks to attract more FDI. They also recommend that Nepal needs to develop and maintain good relations with India and adopt relatively less stringent labour laws than neighbouring countries, among other actions, to encourage FDI inflow to Nepal.

Part III is devoted to energy and water issues in the regional context. Mahendra P. Lama (Chapter 10) looks at the possibility of cross-border energy trade between Nepal, India and China. He lays out ten critical factors that could provide impetus to this possibility. These include effective participations of both India and China in a range of power development projects in Nepal, inability of Nepal to harness its hydropower potential, and development of a large network of power grids and transmissions lines by both India and China. He suggests that Nepal, India, and China can use one or more of the existing five models of energy trading as a basis for developing cross-border energy trading. Christopher Butler and Satis C. Devkota (Chapter 11) propose the method for computing the monetary value of downstream benefits of dam projects. They argue that the downstream benefits can result in two ways. The first is the increased flood control, in which case the value can be computed as a savings from property and personal damage that would accrue each year a dam holds back floods. The second is the augmented irrigation during the dry season, in which case the value can be calculated as the increase in agricultural as well as the household productivity in the downstream areas. The final chapter by Biswo Poudel reviews the current state of Nepal’s hydropower sector and suggests what Nepal must do to benefit from cross-border trade and cooperation.

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