

Nepal

Because of a recovery in agricultural production, the short-term prospects for Nepal's macroeconomy are promising. The new government needs to advance a broad-based reform agenda to sustain this growth. The need to reduce poverty and promote gender equity also raises challenges.

RECENT TRENDS AND PROSPECTS

The macroeconomy was stable in 1999, despite the uncertainty caused by a change in government. Real GDP growth rose to 3.3 percent from 2.3 percent the previous year, led by better performance in the agriculture and industry sectors. However, this growth in production barely exceeded the population growth of 2.4 percent. Consequently, with a per capita GDP of \$210, Nepal ranks as among the poorest countries in the region, lower than most of its South Asian neighbors. While the 3.0 percent growth in agriculture fell short of projections in the Agriculture Perspective Plan, which details the agricultural development strategy for two decades, the increase from the previous year's 1 percent growth was promising, considering that poor weather conditions continued to hamper farmers.

Consistent with an economy dominated by subsistence agriculture, the labor force participation rate was high and the unemployment rate low. About 86 percent of the working-age population (aged 15

and above) is economically active, with 73 percent employed in agriculture. The unemployment rate for the country was less than 2 percent, but the rate in urban areas was higher than 7 percent.

Driven by rising food prices, inflation rose to nearly 13 percent in 1999, from 4 percent the previous year. Poor monsoon conditions led to dramatic increases in the prices of food grains and vegetables. Exports of rice also prevented the usual downturn in price after the main harvest, and the food and beverages index rose by 17.3 percent. Inflation from nonfood items, however, was only 4.3 percent, down nearly 1 percent from the previous year. This was due to the stability of key administered prices, notably kerosene, electricity, and diesel. High money growth continued despite slower inflows of foreign assets. Broad money (M2) increased by about 21 percent in 1999, slightly less than the 22 percent the previous year because of the slow inflow of foreign assets.

The budget deficit remained at 6.1 percent of GDP in 1999, despite additional expenses from the

elections. Preliminary data for 1999 show that domestic revenue collection was substantially lower than the budgeted amount, with actual revenue about 10 percent of GDP, roughly the same as in 1998. The shortfall in revenues was balanced by slower-than-budgeted growth in development expenditures, which rose 9 percent rather than the 26 percent envisaged in the 1999 budget. Even with slower growth, foreign grants and loans financed about 65 percent of development expenditures, compared with 50 percent in the early 1990s, a situation that is unlikely to change in the coming years.

Nepal's current account deficit declined dramatically in 1999 because of strong export growth and a contraction in imports, mainly in aid-related items because of weak investment activity before the elections. Non-aid imports were roughly the same as previous years. While loan disbursements from aid agencies also slowed before the elections, foreign exchange reserves continued to rise. By the end of the year, Nepal had \$797 million in foreign exchange reserves (almost seven months of import equivalent). External debt as a percent of GDP rose in 1998, with

the inflow of foreign aid reaching 54 percent of GDP. However, because of the concessional nature of this lending, the debt-service ratio for external debt was a manageable 6.1 percent of exports in 1998 (see figure 2.15).

A favorable monsoon season and wider use of fertilizer led to a strong recovery in agriculture during the first quarter of 2000. Production of food grains, particularly rice, and vegetables was expected to be above average, leading to GDP growth of 5-6 percent for the year. Early indicators for the tourism, carpet, and garment industries also suggested strong performance. However, with no large projects upcoming until the end of the year, electricity growth should remain slow. Price performance in 2000 will also benefit from bumper harvests throughout the region. The price of rice, which makes up most of the expenditures in the price index, will probably decline after the harvest. Therefore, Nepal can achieve an inflation target of 5 percent in 2000 (rather than the current 7 percent target) with the support of appropriate monetary policy, despite the high-profile increases in prices of kerosene, diesel, and electricity.

Table 2.16 Major Economic Indicators, Nepal, 1997-2001
(percent)

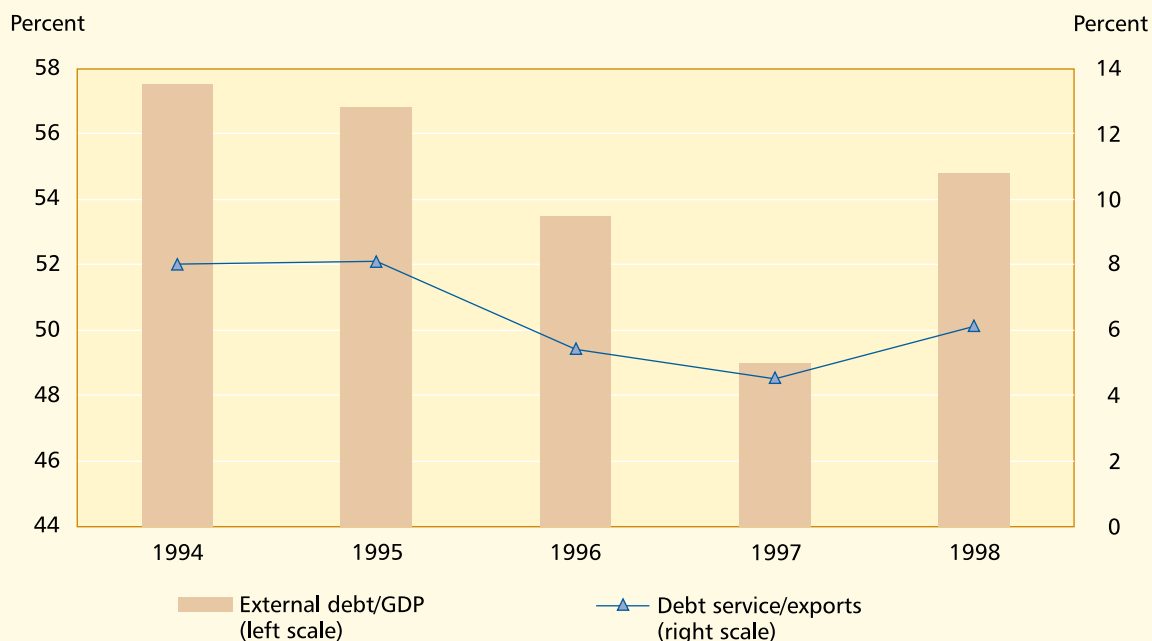
Item	1997	1998	1999	2000	2001
GDP growth	5.0	2.3	3.3	5.5	5.5
Gross domestic investment/GDP	25.3	20.7	17.3	20.0	22.0
Gross domestic savings/GDP	12.1	9.5	10.6	11.7	11.7
Inflation rate (consumer price index)	7.8	4.0	12.7	5.0	5.0
Money supply (M2) growth	11.9	21.9	20.9	14.0	12.0
Fiscal balance/GDP ^a	-5.1	-6.0	-6.1	-7.1	-7.5
Merchandise exports growth	10.2	11.9	20.3	10.0	12.0
Merchandise imports growth	21.7	-12.4	-10.5	15.0	15.0
Current account balance/GDP	-6.0	-5.5	-3.5	-8.0	-9.5
Debt-service/exports	4.5	6.1	6.5	6.5	6.5

Notes: Data are on a fiscal year basis. Data on savings were derived as a residual.

a. Includes grants.

Sources: Central Bureau of Statistics; Nepal Rastra Bank; staff estimates.

Figure 2.15 External Debt and Debt-Service Ratio, Nepal, 1994-1998



Source: World Bank (1999b).

The peg with the Indian rupee provides a useful nominal anchor for the economy, but to sustain it the central bank must reduce the inflation and interest rate differentials with India. A target of 14 percent expansion in broad money (M2) for 2000—with some slowing in 2001—would be consistent with the goal of parity with India, given growth and inflation projections. The central bank needs to liquidate its holdings of Treasury bills, which were acquired through converting the government's overdraft in its budgetary operations. This can help eliminate the negative real interest rates on these instruments and bring the overall interest rate structure in line with India's.

Development expenditures in the 2000 budget are projected to grow by 33 percent. These will be financed mainly by foreign grants, which are projected to increase by 47 percent. Domestic revenue estimates in the current budget are similarly optimistic, with a projected growth rate of 14 percent. Actual revenue performance will hinge on the effective implementa-

tion of the value-added tax. The minimum revenue level for firms covered by the value-added tax was lowered from NRs4.5 million to NRs2 million, and the registration of firms was accelerated to widen the tax base. As in past years, development expenditures probably will bear any shortfalls in domestic revenues and foreign grants. However, preliminary first-quarter 2000 figures suggest that the government's ambitious revenue and development expenditure targets are achievable, even with the increase in allowances for civil servants. The fiscal deficit for 2000 is projected to reach 7 percent of GDP and to continue to rise in 2001.

The current account deficit should widen in 2000 as aid-related imports return to their previous levels, particularly if the government succeeds in its ambitious development agenda. Merchandise imports are projected to grow 15 percent, with investment goods expanding faster than consumer goods imports. Export growth should continue to be strong in 2000, but will slow without the grain exports of the previous

year. The current account deficit is thus expected to reach about 8 percent of GDP in 2000 and more than 9 percent of GDP in 2001. The debt-service ratio should remain around 6 percent of GDP, as much of this debt is concessional.

ISSUES IN ECONOMIC MANAGEMENT

The government's long-term Agriculture Perspective Plan aims to break this sector's dependence on weather by expanding irrigation facilities, improving the distribution of inputs such as fertilizer, diversifying crops, and expanding rural infrastructure. Under this plan, the monopoly of the state-owned Agricultural Inputs Corporation on the import and distribution of fertilizer has been eliminated, price subsidies on all fertilizers have been removed, and private sector trading in fertilizer is on the rise. In the distribution of food grains, the role of the state-owned Nepal Food Corporation is being altered to promote more private sector activity. The government must continue the momentum for reform in this sector and maintain the progress made by avoiding the political temptation to reintroduce subsidies or state-owned monopolies.

While the newly elected majority government raised expectations of reform, progress has been limited. The increase in value-added tax registrations is promising, but filling key vacancies in this department is needed to improve administration, clear the filing backlog, initiate collection visits, and intensify audit activity. The government also raised prices of kerosene, diesel, and electricity. Despite vocal public protests against these measures and a special parliamentary session called by the opposition to review the price increases, the government has stood firm. However, if the country is to achieve the levels of sustained growth necessary to lift it out of poverty, the government needs to take advantage of its majority position to pursue a broad-based reform agenda, with financial sector reform and civil service reform as the core.

POLICY AND DEVELOPMENT ISSUES

Looking beyond the medium-term macroeconomic issues, the government must consider strategies for reducing poverty and raising women's status. In addi-

tion to the equity considerations, the barriers faced by women and the poor limit their ability to provide the basic needs of their families. The system perpetuates itself, as most disadvantaged groups lack the resources to invest in their children's education and health. The people in the poorest regions of the country have the least access to basic health services and the highest rates of infant mortality and child malnutrition.

In Nepal, roughly 42 percent of the total population live in poverty, but the incidence of poverty is only 23 percent in urban areas, compared with 44 percent in rural areas. Geographically, the incidence of poverty in the mid-western and far-western regions greatly exceeds the national average, as does the rate in the mountain districts. Castes with lower social status had higher rates of poverty, as did those without the benefit of education.

One of the chief concerns of the Ninth Five-Year Plan (1998-2002) is poverty reduction, with the objective of reducing poverty incidence by 10 percent by the end of the plan period. However, the breadth of the plan in terms of its targets—covering everything from agricultural production to sports facilities—means the impact on poverty often is lost when the programs are implemented. A more focused plan is needed to provide a comprehensive framework directed toward the primary goal. The government's ongoing review of the Ninth Plan should emphasize the impact on poverty when prioritizing development projects, particularly in view of the emphasis on poverty alleviation by the major donors. In addition, improved information for monitoring the impact of specific projects on poverty is necessary for planning purposes.

Nepal is one of the poorest countries in the world, and its women are among the most disadvantaged. Although there is wide variation across the numerous ethnic groups, the status of women is always lower than that of their male counterparts. Women also lag behind men in access to education, and in ownership and access to assets.

Despite this, women in Nepal have made progress. Women's life expectancy has increased by more than 15 years within the last two decades, although men still live longer on average. The number of women who die in childbirth has decreased, to 539

per 100,000 live births, a vast improvement from the 1980s when the rate was about 50 percent higher. Women are now slightly older when they marry, which has led to a decline in the fertility rate. In education, the gains made by women have been dramatic. Twenty years ago, only 4 percent of the women were literate, and now the rate is 27 percent. For girls, the net enrollment rate has risen to 72 percent for primary school and to 31 percent for lower secondary school. However, men are still more likely to be literate than women, and boys have reached full enrollment in primary school.

Women's economic participation is limited mainly to agricultural production within the household. While the male labor force has been shifting toward manufacturing and services, more than 85 percent of economically active women are in agriculture. Men, however, control the chief inputs to this production: land and real property. These are passed down paternally and a woman's claim to these assets is determined by marriage. It is difficult for women to raise financial capital because they cannot own land, and hence are unlikely to have the necessary collateral. Lower levels of schooling and skills training can prevent women moving from agriculture to other sectors. The preference within households for educating sons and arranging early marriages of daughters reinforces the status quo. Social customs present more hurdles for the women to participate in the economy. In some communities of the southern plains, women are not allowed to mix freely with men.

Nepal's constitution guarantees fundamental rights to all citizens, equal treatment before the law, and equal pay for similar work regardless of gender.

However, these ideals have not been codified in any specific legislation, and the body of family law contains elements that contradict the principle of gender equity. For example, inheritance laws condition a woman's right to parental assets on her age and marital status, and a widow forfeits her claim to her former husband's property if she remarries. The inheritance rights of men, however, are not subject to such conditions. Women have no claims to community property in divorce and spousal support is limited to five years. While the cultural view of women's place in Nepalese society will change slowly over time, the government should work through appropriate legislative reforms toward the principles of gender equity that are espoused in the constitution.

However, legal reforms alone are not enough. For example, prohibitions on violence against women and trafficking in children already exist, but enforcement is often lax. The Ninth Plan proposes to include gender issues in government activities and direct activities to eliminate gender inequalities. Specific action is needed, such as developing women's health programs and ensuring that women do not disproportionately suffer from negative developments such as involuntary resettlement. Improving income-earning capacity is important if women are to become aware of their rights, take advantage of programs offered, and provide feedback for better meeting their needs. Improving conditions for women also will yield important social benefits such as lower population growth and infant mortality, and better health and education for children. Improving women's opportunities helps the families of these women break out of the poverty cycle.