

KEY SHORT-TERM POLITICAL ECONOMY IMPEDIMENTS TO GROWTH

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Consultation Workshop 23 September 2008
Nepal Country Diagnostic Study



There are reasons to be optimistic of about Nepal's short-term growth prospects

Sources of optimism—political:

- Restructuring, greater inclusion and likely devolution could unleash new economic energy, particularly, at the local level
- There is a real opportunity to install a stable democracy and achieve long-term peace
- The “New Nepal” discourse is putting significant pressure on political parties to deliver much needed reform

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Sources of optimism—economic:

- Remittances continue to grow, deposits are growing, fiscal health remains resilient and interest rates are low
- Large, growing economies of India and China could offer new markets and invite new investments
- FDI in hydropower and large infrastructure projects could inject fresh capital in significant volumes

Optimism is not enough; ideas, capacities and incentives are required to drive growth.

- Brilliant growth ideas are scarce.
- Finding them is not enough either, they have to be implemented – “policies are what policies do”
- In implementation, sufficient (state) capacities and right incentives (for policy actors as well as economic agents) are required.
- The optimism begins to fade when the implementation aspect is considered.

Embedded political economy impediments still remain.

A study of a growth idea implemented in the past (namely, the Agricultural Perspective Plan) revealed that the following impediments are critical:

1. Improper mix of political and technical content in the growth ideas

The current discourse on growth and development is ridden with political utopias. These ideas will have to find a technical foundation in order to become viable. On the other hand, a plethora of technical solutions tried in the past ended up failing for the lack of political anchorage.

Embedded political economy impediments still remain.

2. Political Instability:

Political instability distorts both institutional and individual behaviors. At a symptomatic level, political instability tends to cause frequent transfers of leadership, lack or accountability and ownership, disruptions in funding, weakening of institutional commitment and even policy reversals.

3. Volatility of Assumptions:

Political transition keeps basic economic assumptions of the market, institutional behaviors and geopolitical factors volatile. The drafters of the APP in 1995, for instance, could not have foreseen a 10-year conflict siphoning resources from agriculture to security. Nepal's political transition is likely to deny the required visibility to plan and invest in ambitious growth ideas.

Embedded political economy impediments still remain.

4. Inadequate Resources:

Growth ideas cost money, and compete with each other for resources. Sustaining an optimal level of funding during implementation is a challenge common to most growth programs in Nepal. Political instability exacerbates this problem further.

5. The X-factor—foreign assistance:

Resource-wise, foreign assistance is unpredictable both in terms of its focus and level. Unlike other impediments, foreign assistance does not impede growth, at least by design, but it does add unpredictability to the system. Growth (policies) cannot depend on it, yet cannot do without it.

Embedded political economy impediments still remain.

6. Ineffective institutional arrangements:

Entry thresholds and operating efficiencies improve when institutional arrangements improve. Issues such as (lack of) inter-agency coordination, for instance, have been a long-standing impediment to growth programs in Nepal.

7. High transaction costs:

Transaction costs increase when economic exchanges are under-regulated (costs of bargaining, enforcement) and also when they are ridden with rent-seeking regulations. In Nepal both problems exist. Exogenous costs such as security other risks of transitional politics add to the inefficiencies.

Embedded political economy impediments still remain.

8. Asymmetric incentives:

Growth produces winners and losers; growth programs also carry asymmetric incentives for different policy actors and economic agents. Both factors contribute to resistance to growth and reform. Growth based on selective sectors or concentrated in certain locations (growth poles) or focused in certain projects (large infrastructure projects in particular) invariably runs into this problem.

Most pervasive impediments

These impediments were employed to evaluate four sectors/growth ideas that political parties have attached high priority to : hydropower, tourism, land reform and vitalization of the private sector. The following observations were possible:

- Political instability has the most pervasive negative impact on growth;
- Ineffective institutional arrangements are a critical source of failure in most growth strategies; and,
- Growth strategies that induce asymmetric incentives among economic actors are likely to fail during implementation

Recommendations

In response to the three impediments identified, following programming recommendations are made:

1. Give priority to programs that support smooth political transition and constitutional development; the economic benefits of investing on political processes are higher now than any other time in the past;
2. Build broad political consensus on adequately detailed sub-sector policies in areas such as hydropower and private sector vitalization to mitigate the risks of political instability;
3. Invest on the programs that reduce transaction costs (rule of law, enforcement of contract, security, regulatory bottlenecks) to achieve higher level of growth;

Recommendations

4. Promote devolution, build capacities and improve inter-agency coordination at the local level that “unleashing of the local economic energy” becomes more viable.
5. Build low-cost and effective ADR systems for developmental dispute resolution at the local level; particularly in areas where intensification of capital flows, growth programs and infrastructure projects are planned.
6. Strengthen inter-agency coordination and stakeholder participation in government programs. Proactive protocols for enhancing participation and transparency in the planning process can reduce inherent asymmetries in incentives for policy actors and economic agents.