

Foreword

Almost three years into the home-grown peace process, the crucial agenda before Nepal is to ensure sustainable peace. This is just not possible by only finding political solutions to many problems that Nepal is facing. It is necessary for us to accelerate development, achieve higher and inclusive economic growth. Nepal's development lost momentum during decade-long conflict. Since Fiscal Year 2007/08, the economy is showing signs of improvement, but there are many impediments to faster growth and equitable distribution. The conflict is not over yet, as many groups spread in different parts of the country are staking claims for their rightful place in politics and economy.

Without faster development and perceptible change in the lives of ordinary people, we cannot possibly overcome this post-conflict turbulence. We need to move tactfully, clearly identifying the obstacles, implementing reforms that minimize the obstacles, and at the same time using a development strategy that can work even amidst turbulence and obstacles.

The present report does part of what is outlined in the above paragraph. It identifies critical development constraints and recommends a series of measures that can minimize them. Therefore, the government welcomes this report. The diagnostic framework used in the study is an attempt to establish priorities among many candidate policies and institutional reforms aimed at sustained and inclusive growth. The analyses and the informed recommendations geared to fostering growth and overcome poverty, inequality, and other unwanted economic and social outcomes are of immense value to the government.

Nepal, as the report notes, has implemented a number of important policy reforms during the past three decades. Today, Nepal has a thriving financial sector with a vibrant stock market, and a growing tourism sector. It is actively pursuing a policy of converting itself from an electricity deficient nation to a key source of electricity to its fast growing neighbors in the north and the south. In the area of social development, Nepal adopted the Millennium Development Goals and has made some impressive progress in reducing the poverty levels despite low levels of economic growth.

The government, however, is aware that poverty, exclusion, under-employment, and income disparities are persistent reminders of the difficulties that some of our countrymen are still experiencing. The report is, thus, very timely and will be a source of valuable inputs in formulating the country's next development strategy.

The report provides insights that can enrich cooperation between the government of Nepal and development partners, especially the Asian Development Bank (ADB), Department for International Development (DFID), and International Labor Organization (ILO). In particular, we are highly appreciative of the consultative process that the study adopted to ensure that views of all the key stakeholders were taken into account in the diagnosis and formulation of the policy recommendations. The findings and recommendations of the report can form part of the basis for joint work with the development partners toward a common objective of enhancing inclusive and sustainable growth in Nepal. The high priority given, for example, to fiscal management is bound to improve the conduct of official development assistance. The government gratefully acknowledges ADB, DFID, and ILO for the timely conduct of the study.



Rameshore P. Khanal

Secretary

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Preface

Nepal's performance on the economic development front since the turn of the century has lagged behind that of the other South Asian economies. In terms of per capita gross domestic product (GDP), Nepal is now where Sri Lanka was in 1960, Pakistan was in 1970, and India and Bhutan were in 1980. This lackluster economic performance has occurred despite some very important reforms during the 1990s and 2000s. Although the poverty incidence declined from 42% in 1995/96 to about 31% in 2003/2004, it remains high and may climb further if the global recession reduces remittance flows. Another emerging concern is the sharp rise in inequality from 1995/96 to 2003/04.

Although GDP registered an impressive 5.6% growth in 2007/08 compared with 3.0% in 2006/07, the surge was largely due to timely rains leading to a good harvest of the main agricultural crops and to a rise in tourism arrivals—not due to major improvements in economic fundamentals. This raises the question of how Nepal can improve its pace of growth and poverty reduction. Thus the report attempts to identify the most critical constraints that the country faces—constraints that, when removed, can yield the highest welfare gains. The report also attempts to answer how the constraints can be converted into opportunities for long-term growth and how the benefits of economic growth can be translated into faster poverty reduction.

Nepal: Critical Development Constraints presents a diagnosis of Nepal's economy. The diagnosis was led by the Asian Development Bank (ADB) and jointly undertaken with the United Kingdom's Department for International Development (DFID) and the International Labour Organization (ILO). The work at ADB was led by Muhammad Ehsan Khan; Juzhong Zhuang, assistant chief economist, Economic Analysis and Operations Support Division, Economics and Research Department, provided the oversight and overall direction. DFID's work on the study was coordinated by Matthew Greenslade, and ILO's was coordinated by Shengjie Li and Duncan Campbell. The report was prepared by Muhammad Ehsan Khan, Yoko Niimi, and Ma. Rowena M. Cham with contributions from Peter Owen and Duncan Campbell. The report benefited from background papers prepared by a team of experts comprising Mahesh Acharya, Dadhi Adhikari, Devendra Chapgain, Madan Kumar Dahal, Rana Hasan, Niny Khor, Simon Lucas, Mick Moore, Posh Raj Pandey, Rabi Jung Pandey, Sabina Panth, Bishwamber Pyakuryal, Jasmin Rajbhandary, Surendra Rajbhandary, Michel Samson, Shiva Sharma, Bandita Sijapati, Para Suriyaarachchi, and Liz Alden Wiley. Navin Dahal, Lucia Hanmer, Stefan Kossoff, Nick Leader, Andrew Masters, Bishnu Pant, Paolo Spantigati, Raju Tuladhar and Tony Venables provided constructive comments and support in finalizing the report. The report was edited by Jill Gale de Villa; design, layout, and typesetting was by Mike Cortes.

The study followed a consultative process where first the framework and approach and then the study findings were discussed with key stakeholders, including the government of Nepal, academic and research institutions, civil society, development partners, and the private sector. Feedback received during these consultations greatly assisted the report's preparation, and we believe that the report will provide valuable inputs to the formulation of development policies and reform programs aimed at inclusive growth and sustainable development in Nepal.

We are grateful for the support provided by the government of Nepal. In particular, we would like to thank Secretary Rameshore P. Khanal, Ministry of Finance, the government focal point, for his keen interest in the study and guidance in completing this work. We are also grateful for the support and feedback from Dr. Pitambar Sharma and Dr. Guna Nidhi Sharma, former Vice Chairmen, National Planning Commission (NPC); Secretary Janak Raj Joshi, NPC; Secretary Purna P. Kadariya, Ministry of Physical Planning and Works; and Joint Secretary Bimal Wagley, Ministry of Finance. Finally, we also thank the Federation of Nepalese Chambers of Commerce and Industry, Confederation of Nepalese Industries, Nepal Chamber of Commerce, and other representatives of the private sector for their continued support and interest in the study. We look forward to continued and productive dialogue with the government in pursuing an agenda of inclusive growth and sustained development in Nepal.



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