CHAPTER VII
OPENNESS, INCOME DISTRIBUTION AND POVERTY

7.1 TRADE, INCOME DISTRIBUTION AND POVERTY

Nepal is one of the least developed countries and positioned herself at the bottom of seven SAARC countries. Moreover the low level of income is also not evenly distributed among the population. As a result, there is high rate of poverty among the population. It is estimated that the population living with US$ 1 a day is 37.7%(Human Development Report 2003) and the government data indicate that the percentage of population with absolute poverty is about 38% (The Tenth Plan, 2002). Both of the information show that the incidence of poverty is very high in Nepal.

The incidence of poverty varies with ecological zones, with higher incidence in the Mountain and Hilly regions than that of the Terai (Table 5.10). Rural population is at disadvantageous position rather than that of the urban population, as there are higher incidences of poverty in the rural areas. The incidence of poverty is nearly 2 times higher in the rural areas than in urban one (Table 5.11).

Various economic policies and objectives are set up at different fronts to accelerate the development efforts in Nepal to reduce the level of poverty. The adoption of open economic policy is one of the major attempts in this direction. Such open economy generally facilitates trade and creates suitable environment for the growth of foreign investments. In the poverty ridden situations of Nepal, successful economic policies should be adopted to have effective impacts on reducing absolute poverty. So the enlargement of trade and growth of foreign investment are meant to have positive and significant impacts on the poverty reduction.

Many dimensions of trade have brought changes during 1989-2001. There is a rise in the share of trade in the national income. Employment has increased due to the trade activities as discussed above. In Nepalese economy, the labour force engaged in agriculture sector is about 78.1%. It shows relative decline in the labour force engaged in agriculture. However, the absolute number of labour force is actually increased from 7,158,800 to 8,265,038. This clearly indicates that there is an increasing number of labour force engaged in agriculture- the number being 15% during the period of ten years (1991–2001), with 1.45% annual growth of labour force in agriculture. As the annual growth of population is noted to be 2.27% during the decade, the agriculture labour force is growing at slower rate. Due to this variation, the relative share of labour force in agriculture has declined. The agriculture is rural based activity, and any improvement in the agriculture sector would naturally be reflected in the betterment of rural population.

7.1.1 Trade Based on Agriculture Products and Its Impacts on Poverty

The analysis of the agriculture output from 1990/91 to 2000/01, however, portrays dismal picture. As the Nepalese economy is agriculture-based, movement from subsistence agriculture to high value cash crops is considered an important step. Cereals like paddy, maize, wheat etc
are considered as a component of subsistence agriculture as most of these food items are consumed directly by the producers, and only left-over can be traded outside home.

The statistics of output of these cereals indicate that the growth of cereals is not so high. On the other hand, the annual growth rate of paddy during the period of ten years is less than 2%. Other major crops like maize, wheat, barley and millet show similar trends. Maize production has grown by about 2% annually, and wheat production has increased by 4% annually. Barley has also slow growth of output with 0.7% annual growth. Millet has slightly higher annual growth rate of 2.2% (Table 7.1). The relatively weak growth of these basic crops shows that there is still the dominance of these crops as subsistence crop. The output of the cereals has not increased considerably, though the absolute population in agriculture has not declined; rather it has increased by about 1.5% annually. The slow rise in production indicates that there is not much room for enlargement of the trade of these crops.

As the majority of the Nepalese farmers are engaged in these crops, the slow growth of these crops indicates limited improvement in their income. It implies that there has been no significant impact on the subsistence agriculture sector for poverty reduction during the globalization period. Based on Nepal Labour Force Survey, there are 67.3% of the total population engaged in subsistence agriculture, where the agriculture labour forces are self-employed. In the market agriculture, where labour force is employed as paid employees, only 2.9%, of the population is engaged. It thus shows that, out of about 78.1% of the population engaged in agriculture, most of them are engaged at subsistence level1. The agriculture in the form of a market institution for employment is at very small level.

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<tbody>
<tr>
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<td>3579</td>
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<tr>
<td>Maize</td>
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<td>1291</td>
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<td>1273</td>
<td>1331</td>
<td>1312</td>
<td>1367</td>
<td>1346</td>
<td>1445</td>
<td>1484</td>
</tr>
<tr>
<td>Wheat</td>
<td>846</td>
<td>779</td>
<td>765</td>
<td>873</td>
<td>914</td>
<td>1013</td>
<td>1056</td>
<td>1001</td>
<td>1086</td>
<td>1184</td>
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<td>Barley</td>
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<td>29</td>
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<td>39</td>
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<td>32</td>
<td>31</td>
<td>30</td>
</tr>
<tr>
<td>Millet</td>
<td>231</td>
<td>229</td>
<td>237</td>
<td>274</td>
<td>268</td>
<td>282</td>
<td>289</td>
<td>285</td>
<td>291</td>
<td>295</td>
<td>283</td>
</tr>
</tbody>
</table>

Source: CBS and Ministry of Agriculture and Cooperative, Agriculture Statistics Division

The open economy is expected to bring new technology, which can help to increase productivity in agriculture. Productivity analysis of the cereals, however, does not show any indication of improvement. The productivity measured in terms of yield per hectare of the major cereals shows that the output per hectare is fluctuating (Fig.7.1). However, in the case of wheat, there is slight upward trend in the productivity. This indicates that major cereal has failed to gain any productivity growth, as expected from the adoption of the open economic policies.

1 Nepal Labour Force Survey indicates different proportion of labour force engaged in agriculture.
7.1.2 Price, Openness and Poverty Reduction

When the economy is opened up, it is expected that the goods with comparative advantage will fetch high price. As a result, the production of such goods are expected to rise. In the Nepalese context, most of the people are employed in the agriculture sector, which is rural based. And poverty is much higher in the rural sector. So any sign of poverty reduction should be associated with the improvement of the value of agriculture product, which should be reflected in terms of its price.

Analysis of the real price of major agricultural products based on the price of 1994/95 indicates that there is no substantial increase in the price of these crops. There is not much rise in the real price for any products, and they have been in declining trend at present. One of the targets of the liberalization is the creation of the correct price incentives. The changes in price are expected to bring forward a positive supply response from farmers. As a result, there will be rise in output and productivity generating higher income in the rural sectors. However, the price change indicates that there is no price incentive to the farmers. So no positive consequence of rise in output and productivity has been found during the globalization period.
The price response after the implementation of liberal economic policies is more distinct in the agriculture inputs in an unfavorable way to the farmers. (Fig.7.3). This, in turn, has reduced the level of investment in agriculture, and productivity is not increased. On the other hand, comparison of price of input with output shows negative impacts on agriculture. The price of inputs based on the price of fertilizer shows that the price has increased nearly five times during these ten years. When the price of outputs is compared, it has nearly doubled only for wheat, corn and potato. Other agriculture products like rice, millet, onion etc show less than double in the price rise.

The withdrawal of subsidy from fertilizer has resulted into such wide variation between the price of outputs and inputs. Apart from the withdrawal of subsidy from fertilizer, there are also withdrawals of subsidy in other inputs like irrigation (shallow tube wells). The supply of fertilizer has definitely increased due to the open and liberal economic policies with the entry of private sector in fertilization trade. However, the lack of monitoring system on the quality of fertilizer has created hardship for the farmers. It thus indicates that the price instrument in Nepal is not towards pro-poor.

Fig 7.3: Changes in Price of Agricultural Inputs and Outputs

![Price of Agricultural Inputs and Outputs](Image)

Source: Economic Survey (Various Issues)

One of the expected changes in the agriculture in open and competitive economy is related with diversification of crops with a focus on other profitable agriculture products (Table 7.2, Fig. 7.4). Many agricultural products like fruits, vegetables and cash crops are expected to replace cereals, if cereals are not drawing high prices. Such changes are the expected outcomes of the liberal trade policies and represent the commercialization of agriculture sector to some extent.

The analysis indicates that the outputs of vegetables, meats, eggs, fish and pulses have increased. The fish products have showed maximum growth in ten-year time, may be because of small base to start with. Other important agriculture products with significant growth are eggs, meat, vegetables, and potatoes. The producers generally produce these products for trading purpose rather than for direct consumption. Moreover, these products are to serve urban market. This analysis indicates that there are changes in agriculture practices with a focus on the products, which can be traded. But, due to the lack of data, it is hard to analyze its role in poverty reduction.
Table 7.2: Output of Agricultural Products other than Cereals

(Thousand M.ton)

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</thead>
<tbody>
<tr>
<td>Pulses</td>
<td>161.32</td>
<td>154.54</td>
<td>191.14</td>
<td>204.69</td>
<td>201.78</td>
<td>214.85</td>
<td>223.00</td>
<td>215.70</td>
<td>228.84</td>
<td>237.32</td>
<td>243.24</td>
<td>250.40</td>
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<tr>
<td>Fruits</td>
<td>502.36</td>
<td>502.00</td>
<td>519.59</td>
<td>535.00</td>
<td>565.00</td>
<td>567.49</td>
<td>428.23</td>
<td>425.60</td>
<td>456.00</td>
<td>447.33</td>
<td>487.33</td>
<td>473.62</td>
</tr>
<tr>
<td>Vegetables</td>
<td>970.20</td>
<td>1128.00</td>
<td>1197.00</td>
<td>1258.55</td>
<td>1327.20</td>
<td>1350.00</td>
<td>1412.20</td>
<td>1342.57</td>
<td>1489.66</td>
<td>1652.98</td>
<td>1738.09</td>
<td></td>
</tr>
<tr>
<td>Meat</td>
<td>147.08</td>
<td>148.42</td>
<td>149.89</td>
<td>153.52</td>
<td>159.24</td>
<td>161.52</td>
<td>174.27</td>
<td>180.67</td>
<td>185.03</td>
<td>189.16</td>
<td>194.26</td>
<td>198.64</td>
</tr>
<tr>
<td>Milk &amp; milk Production</td>
<td>865.42</td>
<td>871.82</td>
<td>876.59</td>
<td>885.30</td>
<td>903.64</td>
<td>961.56</td>
<td>1012.16</td>
<td>1048.04</td>
<td>1072.94</td>
<td>1097.02</td>
<td>1124.13</td>
<td>1158.70</td>
</tr>
<tr>
<td>Egg (in Million)</td>
<td>369.52</td>
<td>368.16</td>
<td>370.93</td>
<td>357.10</td>
<td>412.11</td>
<td>396.40</td>
<td>421.59</td>
<td>440.90</td>
<td>460.62</td>
<td>480.80</td>
<td>507.32</td>
<td>538.42</td>
</tr>
<tr>
<td>Fish</td>
<td>14.58</td>
<td>16.50</td>
<td>15.19</td>
<td>15.52</td>
<td>17.58</td>
<td>21.88</td>
<td>23.20</td>
<td>24.86</td>
<td>25.75</td>
<td>31.72</td>
<td>33.27</td>
<td>35.00</td>
</tr>
<tr>
<td>Sugarcane</td>
<td>31.71</td>
<td>33.59</td>
<td>34.52</td>
<td>35.95</td>
<td>35.49</td>
<td>35.99</td>
<td>35.09</td>
<td>35.39</td>
<td>35.13</td>
<td>36.58</td>
<td>36.18</td>
<td>37.23</td>
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<tr>
<td>Oil seeds</td>
<td>0.64</td>
<td>0.59</td>
<td>0.57</td>
<td>0.57</td>
<td>0.59</td>
<td>0.64</td>
<td>0.61</td>
<td>0.64</td>
<td>0.65</td>
<td>0.68</td>
<td>0.89</td>
<td>0.88</td>
</tr>
<tr>
<td>Tobacco</td>
<td>0.87</td>
<td>0.96</td>
<td>0.92</td>
<td>0.86</td>
<td>0.90</td>
<td>0.91</td>
<td>0.90</td>
<td>0.88</td>
<td>0.80</td>
<td>0.88</td>
<td>0.89</td>
<td>0.94</td>
</tr>
<tr>
<td>Potato</td>
<td>8.04</td>
<td>8.82</td>
<td>8.59</td>
<td>8.43</td>
<td>8.76</td>
<td>8.62</td>
<td>8.48</td>
<td>8.74</td>
<td>8.39</td>
<td>9.49</td>
<td>9.64</td>
<td>10.10</td>
</tr>
<tr>
<td>Jute</td>
<td>1.23</td>
<td>1.14</td>
<td>1.27</td>
<td>1.11</td>
<td>1.21</td>
<td>1.20</td>
<td>1.34</td>
<td>1.27</td>
<td>1.26</td>
<td>1.33</td>
<td>1.04</td>
<td>1.45</td>
</tr>
</tbody>
</table>

Source: Economic Survey (Various Issues)

Fig 7.4: Growth of Some Agriculture Outputs Other than Cereals

Though there have been some indications of trade diversifications in agricultural products during the liberalization period, benefits accrued by the agriculture sectors as a whole have really been reduced than that of non-agriculture sector. Such indications can be observed when the terms of trade in agriculture sector are analyzed. Analyses of the relative changes in the prices of the agricultural and non-agricultural sectors are made at constant price of 1984/85. The agricultural sector has been found to have a favorable increment until 1990. If the deterioration is noted, it can be said that the term of trade for agriculture has declined rapidly reaching the lowest value in 1994/95. Though there has been some upward movement in terms of the trade after 1994/95, such changes are found very limited. (Fig. 7.5)
The impacts of the policies adopted by the government in agriculture have two edges. The withdrawal of subsidy has increased the price of agriculture inputs. Government also has decided not to intervene market with minimum price for agriculture products. As a result, the price of output could not fetch even the minimum price. The situation of the farmers has further worse due to the inflow of the agriculture products from India, where farmers are still receiving support from the government with subsidy in fertilizer, power and other extension services. All these factors have created unfavorable terms of trade in agriculture during the post liberalization period.

The only possible way out for farmer to utilize liberal economic environment is to produce those agriculture products, which could fetch better price. Though there is a trend in identifying such products, the efforts appear to be inadequate. New agricultural products should be identified, which can be produced at lower cost, but can fetch higher price for farmers. Ecological variations provide opportunities for Nepalese farmer to carry on such practices. Off-season vegetables, seeds or seedlings are some potential products for diversification.

### 7.1.3 Urbanization, Trade and Poverty

It is expected that the effect of open economy be more reflected in trade. Trade generally helps in the promotion of urbanization and concentrates on the urban sectors. So the growth of urbanization is the cause and effect of trade. In the Nepalese context, the growth of urbanization can be interpreted in two ways. First, it indicates the enlargement of trade volume. Formal trade helps to build urban centers and urbanization drives for rise in informal trade. The second important interpretation is related with poverty level. The available data on poverty show that the urban sector has lower incidence of poverty. So the growth of urbanization is the indication of poverty reduction in general.

The urbanization scenario of the last thirty years shows that there is an increasing trend of urbanization in Nepal. (Table 7.3). The rising urbanization situation has helped in the expansion of construction activities and development of various services in the urban areas. This has enlarged the informal sector in trade and industries. This has created an opportunity to have better income earning opportunities in such urban areas.
Table 7.3: Distribution of Rural-Urban Population in Nepal

<table>
<thead>
<tr>
<th>Census Year</th>
<th>Percent of Urban Population</th>
<th>Percent of Rural Population</th>
<th>Annual Growth Urban</th>
</tr>
</thead>
<tbody>
<tr>
<td>1961</td>
<td>3.6</td>
<td>96.4</td>
<td>4.5</td>
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<tr>
<td>1971</td>
<td>4.0</td>
<td>96.0</td>
<td>3.2</td>
</tr>
<tr>
<td>1981</td>
<td>6.4</td>
<td>93.6</td>
<td>7.5</td>
</tr>
<tr>
<td>1991</td>
<td>9.2</td>
<td>90.8</td>
<td>5.9</td>
</tr>
<tr>
<td>2001</td>
<td>14.2</td>
<td>85.8</td>
<td>6.6</td>
</tr>
</tbody>
</table>

Source: Central Bureau of Statistics

The trade sector, both domestic and international trade, has also generated employment opportunities. The employment opportunities so created will obviously draw labour from agriculture sector, and such activities will definitely raise the income of the persons who have left agriculture. At the same time, the reduction of the number of labour force in agriculture will also help to raise income of those people, who have left behind the agriculture sector.

The growth of the urban sector has created suitable environment for the rise of many service sectors. School education has become one of the major areas. Low quality of education in public schools, growing awareness among parents to provide better education, private school as a way of employment and increase in urban population are some major reasons for the growth and progress of the schools in the private sector. The number of the schools has increased by five times during the period. Such increase has provided employment opportunities for more than 37,000 people, which is four times higher than the number of 1989 (Table 7.4). Such positive impact is clearly the outcome of growing urbanization. But this may indicate unequal distribution of income as well. Generally, the job created in the schools is mainly for skilled labours, who have some academic background. So the job is not for the poor people. At the same time, the benefit created by such schools are for those families, who can afford private education, which is more expensive than the government run schools.

Table 7.4: Number of Schools, Teachers and Students in Private Schools

<table>
<thead>
<tr>
<th>Year</th>
<th>Schools</th>
<th>Students</th>
<th>Teachers</th>
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<tbody>
<tr>
<td>1989</td>
<td>2698</td>
<td>222466</td>
<td>9184</td>
</tr>
<tr>
<td>1990</td>
<td>2710</td>
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<td>303931</td>
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<td>1992</td>
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<td>1993</td>
<td>5367</td>
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<td>26184</td>
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<tr>
<td>1998</td>
<td>9688</td>
<td>590896</td>
<td>26902</td>
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<tr>
<td>1999</td>
<td>11992</td>
<td>795180</td>
<td>37568</td>
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</table>

Source: Education Statistics, Department of Education

The analysis hints that trade has relatively more positive impacts on the urban sector. The enlargement of the external trade generally leads to the establishment of manufacturing units in and around urban centers as these centers have basic infrastructure like power, and communication. Rural people definitely move into the urban centers to work as a labour, and those who are left behind in the villages cannot receive such benefit of employment. On the
other hand, agriculture products produced in the rural areas show price deteriorations (Fig 7.3). They are the primary products, and the producers supply such products to urban centers and, in turn, they buy goods and services produced in the urban areas, which have higher value in terms of price. So the rural population is facing deteriorated terms of trade.

Unfortunately, the major products exported from Nepal also are not the output from the rural sector. The major export items carpet, garment, vegetable ghee and pashmina entirely depend on raw materials imported from the urban sector. So there is no backward linkage of these major export items favoring the rural areas in terms of raw materials.

The migration from the rural areas to the urban centers for employment created due to the liberal policies might have brought some negative consequences in terms of the income distribution as indicated by Gini Coefficient (Table 5.2). The rural labour, which is mostly unskilled, might have either limited opportunities for the employment or might be able to get only seasonal employment. As a result, the urban poverty might have increased (Table 5.5). Again the lack of systematic information about the labour force has made the analysis difficult.

7.2 FDI, INCOME DISTRIBUTION AND POVERTY

Foreign direct investment is the important aspect of liberal economic practices. As capital and technology are important resources for developing countries, foreign investors are lured to invest in Nepal; so Nepalese economy too has an access to these vital resources. As free, competitive economy is basic requirement to attract the foreign economic investment, Nepal has adopted such policies keeping an eye on the opportunities for receiving foreign investment. The increasing foreign investment has been expected to generate employment opportunities, poverty reduction and overall economic growth of the country. Unfortunately, the expectations of the government after the adoption of open and liberal economic environment—that FDI would increase and thus there would be streams of benefits in terms of employment in poverty reduction and economic development—could not be realized. Many reasons are accountable for this. Some major reasons are analyzed in the subsequent sub-sections.

7.2.1 Limited Entry of FDI

In Nepal, the investment from the foreigners did not occur to the level of expectations. Though there is distinct rise in the volume of FDI with an average of US$ 9.5 million per annum during the liberal economic environment period of 1991-2001, as compared to the annual flow of US$ 0.3 million of 1980-1990, it is far less when compared with other neighboring countries of South Asia (Table 3.25). Nepal has been able to draw only 0.4% of the total FDI flow in SAARC region during the decade (Fig. 7.6). It clearly indicates that the hard work done by Nepal to create open economy could not bear proper fruits. The limited flow of FDI thus could not create any significant impact in poverty reduction attempts of Nepal.
7.2.2 Distribution of FDI Based in Geographical Region

In Nepal, poverty has geographical characteristics. Available data show that poverty is more rampant in the Hills and Mountains than that of the flat land of the southern Terai. Similarly it is more concentrated in Far Western and Mid Western Development Regions of Nepal.

Analysis of the geographical trend of FDI in Nepal shows that FDI is more concentrated in the Central Development Region. Data shows that 77.7% of the projects are located in Central Development Region, 13.9% in Western Development Region and 5.4% in Eastern Development Region (Table 3.28).

In the most backward regions, namely Mid Western Development and Far Western Development Regions, 1.7% and 1.0% of FDI are respectively established. (Table 3.28). This shows that there are limited inflows of FDI, and these are also concentrated in relatively better off location of Nepal in terms of poverty. The role of FDI in poverty reduction in the most backward areas thus looks limited.

The role of FDI in poverty reduction in Nepal cannot be associated only with the direct employment opportunities provided by foreign investment. Commercial activities may create backward linkages or there occur spillover effect, which are beneficial to the poor people. The priority of statistics does not allow us providing systematic information on the analysis of the role of FDI in poverty reduction, via its backward linkages or its spill over effect. The foreign direct investment related with the power sector has spillover effect in surrounding areas in terms of the infrastructure development, power supply to the local community and other social development. Some manufacturing units like Dabur Nepal, which is India based pharmaceutical organization, does have positive backward linkages. Its raw materials like honey, medicinal herbs etc are collected from the rural areas. Due to the growing demand of honey, many bee-farms are found developed in different rural areas of Nepal. These are definitely positive impacts of FDI, but quantitative time series data are not available to ascertain the degree of benefit.
7.3 **Trade, FDI and the Informal Sector**

Growing trade has some effect on the growth of the informal sector. Informal sector is defined as non-agriculture establishments, which employ no outside labour, except family members or less than 10 persons, and are not registered (NLFS, 1999). The addition of the new products in the market, the rise in income due to the increase in employment number and other related activities have enlarged the informal sector. There is a growth in small-scale retail operations and manufacturing practices. Various agriculture activities like livestock, fisheries, and chicken farming, off-season vegetables and fruits have increased during the period of liberal economic decade.

The informal sector also possesses in Nepal same characteristics as in other countries. They have the following characteristics:

- Not recognized, registered, regulated or protected under the law
- Tremendous diversity and heterogeneity
- Increasing informalization of production and employment relationships in Nepal

In Nepal, the informal economy is growing everywhere, and it is very much linked with poverty. In the informal economy, there are:

- Employers: owners and owner operators of informal enterprises
- Own-account workers: heads of family business; self-employed; street vendors; unpaid family workers
- Wage workers: employees of informal enterprises; casual workers without a fixed employer; home workers; domestic workers; temporary or part-time workers; unregistered workers; undeclared workers.

The enterprises tend to be informal because of the commercial law or administrative procedures for business registration too difficult, costly or unsuitable, taxation system or social security system too cumbersome, labour code too restrictive, inflexible, enterprise sees no benefit from registration, and enterprises need to reduce costs to be competitive.

The workers in Nepal are informal because they can not find formal jobs and therefore work in informal enterprises; they are outside the coverage of labour legislation and regulations; the law has failed to keep up with changes in the labour market or economic organization; and the enforcement mechanisms are lacking or too weak to register, inspect or protect such workers.

Currently in Nepal, new form of informality is developing and has the following features:

- Workers outside the legal and regulatory frameworks of the economic and social mainstream, e.g. undocumented immigrants
- Increasing informalization of production and employment relationships in the context of globalization as globalization has expanded trade activity in the informal sector with a rapid increase in export as well as in import.
- More jobs, less social protection for the workforce
- Macro-economic reforms leading to massive retrenchments and fewer ‘formal’ jobs
When the changes in income distribution and degree of poverty is observed, some positive impacts are observed due to the enlarged trade and increasing foreign investment, though it is found difficult to establish distinct correlation between the trade and foreign direct investment with poverty and income distribution. In general, it is reflected by overall statistics.

There is a rise in average income in Nepal. The average income of a Nepali was Rs 14,796 in 1984, which increased to Rs 43,700 in 1996 (Table 5.1). The share of farm income declined from 69.2% to 65% in the rural area during that period. In Nepal, the share of farm income declined from 64.4% to 61% during that period. This is an important clue to link trade and foreign direct investment with income distribution. The most significant economic events during that period is related with growth in trade and FDI and so the changes in income distribution can be attributed to these sectors. The share of wage income has also increased from 31.7% to 36% in the urban areas, whereas it has changed from 15.6% to 27% in the rural areas. The rise in the share of wage income represents the employment opportunities, and it indicates the positive impact of the globalization.

The distribution of income is not even as reflected by Gini coefficient. It is found deteriorated (Table 5.2). The value of Gini coefficient was 0.23 based on per capita income in 1985 for rural areas, and it changed to 0.31 in 1996. Similarly the value of Gini coefficient for urban areas changed from 0.26 in 1985 to 0.43 in 1996. These data indicate that the income distribution is not even.

The incidence of poverty has not improved during the globalization period. In 1989, the estimates of the World Bank/UNDP indicated that the incidence was around 42%, which further increased 47% in 1996 as per estimates of CBS (Table 5.16). The failure to reduce poverty level was observed in the rural as well as in the urban areas (Table 5.17). The current government estimates of poverty level of around 38%, however, shows positive impact of the globalization in the poverty reduction in Nepal. (The Tenth Plan, 2003-2007).

7.4 THE IMPACT OF POLICIES FOR INCREASING OPENNESS

Growing openness as reflected by the trade policies, industrial policies and financial sector reform policies has various effects on different economic indicators. The creation of employment opportunities, reduction in the incidence of poverty, flow of fund towards private sector, rise in foreign investment, increase in the size of trade and improvement in the balance of payment situations are some of such indicators. However, it is not easy to build a clear model, which shows the distinct impact of various policies adopted by the government during the period of economic liberalization in these different indicators. Lack of comparable time series data is the major hurdle for doing analysis of policy impact on poverty.

7.4.1 Trade Policies and Poverty Reduction

The major thrust of the open economy is the promotion of trade. When a country expands its trade, it is expected that there will be positive impact on the national output and employment opportunities, which eventually will bring down the incidence of poverty. Nepal had adopted liberal trade policies in 1992, with substantial changes in tariff, simplification of trade
procedures, emphasis on the role of private sectors with the objective of enlarging domestic as well as international trade. There are some major objectives as given below:

- To diversify trade by identifying, developing and producing new export products;
- To make export trade competitive and sustainable by establishing backward linkages;
- To expand trade on a sustainable basis by gradually reducing trade deficit;
- To establish co-ordination with other sectors for employment-oriented trade expansion.

Necessary policies in regard to the export, import, foreign exchange arrangement and domestic trade are also formulated to achieve these objectives. Major changes due to such policy reform can be noted as an elimination of quantitative restriction on imports, reductions in tariff rate and move towards uniform tariff structure. Some important institutional changes have also been carried out with the representations from the private sector to build up coordination among different agencies involved in export trade.

There are definite positive trends of international trade. The total volume of external trade has significantly increased as indicated by the ratio of total external trade with GDP. In 1988/89, it was about 22.9%, but by 2000/01 it became 41.69% (Table 3.1). This is a significant change in trade. There was growth in both export and import. The export was only 11.82% of GDP during 1990/91, but it rose to 23.13% in 2000/01. Similarly import rose from 23.08% of GDP to 31.36% during the same period. This clearly indicates the rise in trade due to the adoption of liberal policies. Similarly, it is estimated that there is 6% annual growth in trade during the globalization period (Fig 6.2).

Based on these information, it is tempted to conclude that trade policies have positive impacts on the poverty reduction as there is a rise in trade after the adoption of such policies. However, in the Nepalese context, such conclusions are not easy to draw. There is a wide disparity between the rural and urban sectors, in terms of economic activities. Rural sector is agriculture based, whereas the urban sector is focused on other economic activities. Moreover, poverty is more acute in the rural sectors, nearly with double amplitude of the incidence. Thus it is quite possible that, due to the expansion of global trade, urban people are more benefited as trade activities are focused on the urban sector. The important export items like carpet, garment and vegetable ghee, which share about 70% of the total trade, are urban based. These industries require many infrastructure facilities like road, electricity and communication services, which are available in the urban sector. So the industries are based on urban sector. Another negative aspect of these major exportable items is that these industries have very limited backward linkage, which could have benefited from the rural sector. Raw wool for carpet industries, fabrics and other accessories of the garment industries and oils for vegetable ghee industries are all imported. Due to this nature of current exportable products of Nepal, only urban population are seen to have been extracting the opportunities. It might have widened the gap between the rural poor and better off urban people.

Import enlargements also have urban based character. Major importable items like petroleum products, various consumable durable and non durable items are possible to consume at urban settings only. On the other hand, these items are not only consumed at city centers but also
traded in the urban sector only. This means that the enlarged sizes of import are traded in the urban sectors only, thus further providing benefits only to the urban population due to the employment to trade these goods and services in the urban areas. It has further widened the income gap between the urban and rural people.

Moreover, decline in tariff rate has also negative impact on revenue generation. Such reduction of the revenue definitely creates hurdles to invest on health, education and infrastructure development in the rural sector, thus further enlarging the income disparity.

As the rural population is 85.8% of the total population and there is nearly 2.1 times higher incidence of poverty in the rural areas, the effects of the urban based trade policies might have limited role in poverty reduction.

7.4.2 Industrial Policies and Poverty Reduction

The industrial policies formulated during early 90's focused on the need of open and competitive environment for production and simplification of procedures for investment so that the local entrepreneur would be attracted to invest. The other important goal designated in the industrial policies was to attract foreign investment in Nepal, expecting that such foreign investment would bring capital and technology that might be taken the scarce content for economic development of Nepal. Many policies and Acts were formulated in this area, the important one being Industrial Policy 1992. Besides this, Industrial Enterprise Act 1992, Foreign Investment and One Window Policy, Foreign Investment and Technology Transfer Act 1992, and Company Act 1992 were also formulated. Some institutional bodies, like Industrial Promotion Board (IPB), One Window Committee, were formed with the representation of the private sector to formulate and implement the policies.

The important aspects of these policies were related with enhancement of competition. Withdrawal of the state support by dismantling the tariff wall was the consequence of such industrial policies. As an impact of the reduction in tariff rate, average effective rate of protection in manufacturing declined sharply as shown in Table 7.5.

<table>
<thead>
<tr>
<th>Year</th>
<th>Average effective rate of Protection</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989</td>
<td>111.4%</td>
</tr>
<tr>
<td>1992</td>
<td>16.0%</td>
</tr>
<tr>
<td>1996</td>
<td>8.5%</td>
</tr>
</tbody>
</table>

*Source: Karmacharya, 2000 (In the Macroeconomics of Poverty Reduction: The case study of Nepal- UNDP, 2003)*

Many local industries could not survive due to the sudden increase in competition with the imported international products. So the frequency of sick industries is increased as indicated by declining capacity utilization. There were even shut down of some industries. The major suffering units are flour products, cotton textile, synthetic textiles, tanned leather, stainless steel utensils, and plastic goods (*Table 3.12*). Unemployment generated by the declining-capacity-utilization and shut-down-situation, capital locked in such sick industries causing losses to the investors are some of the negative consequences of the liberal economic policies.
But it is not that all the industries have suffered in the negative way. Some industries like vegetable ghee, garments, carpets, cigarette and dry cell batteries have shown positive sign of rising capacity utilization. Expansion of external as well as internal markets has helped to flow capacity utilization.

There is a rapid increment in the registration of industries, mainly in cottage and small-scale industry level (Table 3.16). The annual registration rate nearly doubled during the period of 1991/92 - 1999/2000 and proposed fixed capital investment increased five times during that period.

The pros and cons of these industrial policies are now least visible in the rural sectors of Nepal. These industries are found to be in and around urban centers due to the availability of infrastructure facility like road, electricity and communication services. Moreover, with the expansion of market in the urban centers, these industries are also attracted towards the urban centers.

The high dependency of the population on the rural-based agriculture sectors, very low level of skill associated with these rural population as indicated by low literacy rate, and dominancy of ultra poor mostly from the marginalized population of Nepal in agriculture sectors, indicate that poverty is more common among these classes of citizens. Such citizens are not positively affected by the current industrial development after the adoption of liberal economic practices. Their economic status could not increase but has made them rather worse-off.

The adoption of policies to attract foreign investment has also created opportunities for employment, as there is a rise in the foreign investment. The employment generation of FDI was only 28716 before 1992, but increased three times after the implementation of the liberal industrial policies with the employment of 87784 upto 2001/02 (Table 6.9). The average flow of the volume of FDI during 1991-2001 was found to be US$ 9.5 million per annum, which was much higher than that of 1980-1990, as the average flow during 1900-2001 was $ 0.3 million per annum (Table 3.25).

Analysis of the foreign investment in relation to the adoption of open economic policies shows two distinct aspects: These foreign investments are basically focused manufacturing, tourism and service sectors (Table 3.26). There is no significant investment in the agriculture sector, where the majority of people are involved in absolute poverty work. This indicates the limited benefit of the foreign investment in poverty reduction. Moreover, the foreign investment in Nepal during the period, when compared to other countries of SAARC region, is virtually insignificant (Table 3.25). Bangladesh has nine times higher rate of inflow from foreign investors than that of Nepal, whereas in India, it is 200 times higher than that of Nepal. It clearly indicates Nepal’s scanty success on attracting foreign investment in Nepal. Thus the adoption of the liberal economic policies has very limited impact on the reduction of poverty in Nepal.

### 7.5 The Role of Financial Liberalization

Financial sector has observed the most dramatic changes after the adoption of liberal economic policies in Nepal. The response of this sector is also significant as the sector has exhibited rapid growth due to these changes. Due to the increased number of banks, finance companies and cooperatives, number of economic activities have been increased, resulting into the rise of
employment opportunities and acceleration of economic activities, which can have wide multiplier effects on the life of the people in Nepal.

There are three distinct aspects of financial liberalization in relation to the poverty reduction in Nepal: The first aspect is related with the urban bias character of financial sector. The other important aspect is related with the impact of liberal financial policies on the flow of funds to the poor population; and lastly the flow towards agriculture sector, on which most of the poor people run their economic activities.

7.5.1 Urban Bias Character of Financial Institutions and Poverty Reduction

Historically proven financial sectors have urban bias characters all over the world. Due to the infrastructure facilities in the urban sector, ability of debtors to offer economically viable mortgage to draw loan, higher demand for loan in the urban sector, relatively higher amount per loan in urban sectors than that of the rural areas and larger potential of urban sectors to provide deposits have made the banks and financial sectors mostly engaged in the urban sectors. The flow of credit is collateral base in Nepal, as 86% of the credits from the financial institutions are against the collateral (UNDP: 2003). This data indicate that rural population will not be able to get the credit from financial institutions because 49% of the households possess less than 0.5 hectares of land. Such households are mostly in the rural sectors, and the incidence of poverty is more rampant in the rural sectors. It indicates that the credit flow to the very poor people in the rural area is not possible.

To overcome these obstacles, the Central Bank in Nepal, Nepal Rastra Bank (NRB), has directed commercial banks to expand services in the rural areas and priority sectors so that credit would be available to the rural sector, where the incidence of poverty is higher than that of urban sector. Such directives are not followed by some commercial banks, specially the joint ventures ones. NRB has tried to direct banks to flow funds in the rural sector, by adopting penalty system in the case of failure to fund at the rural sectors. But these commercial banks have preferred to pay penalty being failed to flow funds in the rural areas and priority sectors, rather than funding in the rural sectors.

NRB has tried to break this tendency of avoiding rural sector, by directing commercial banks to open branches in the rural sector. If branches are opened in the rural sector, there would be definitely a rise in the financial sectors in the area. So there is instruction from NRB to open a branch in the rural sector for every branch in urban sectors. But this directives of the Central Bank to open a branch in the rural sector for every branch in urban sectors have not been followed by the Commercial Banks, expressing their clear interest in urban sectors. Before the adoption of liberal economic policies, there were government regulated banks and so the branches could be opened as per instruction of the government. After the adoption of liberal economic policies, the joint venture banks and private banks operated with distinct profit motives. So they avoided rural sector due to the low rate of return.

Table 7.6: The Share of Rural Banks

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Branches</th>
<th>Rural Branches</th>
<th>Urban Branches</th>
<th>Rural Branches as % of the Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>241</td>
<td>154</td>
<td>87</td>
<td>63.9%</td>
</tr>
<tr>
<td>1990</td>
<td>460</td>
<td>300</td>
<td>160</td>
<td>65.2%</td>
</tr>
<tr>
<td>2000</td>
<td>478</td>
<td>285</td>
<td>193</td>
<td>59.6%</td>
</tr>
</tbody>
</table>

Source: NRB
The available data of the rural bank branches as the percentage of the total commercial bank branches show that there is urban bias of banking sector in the liberal economic environment. Numbers of the rural banks are found to be declining in absolute number, and the share of the rural bank in the total bank is also declining. Since the rise of the population in rural areas is higher, one branch of a bank is serving 68000 population, while in the case of urban area, one branch is serving 16,700 population. The declining banking activity at the rural sector is not supportive to reduce the poverty level of the rural area. This indicates the urban bias character of the banking sector in Nepal. So the urban bias character can not be considered positive for poverty reduction in Nepal, where the frequency of poverty is much higher in the rural sector.

7.5.2 Flow of Funds to the Rural Sector and Poverty

The rural credit system is established in Nepal to increase the flow of funds to the rural sector. As poverty is found to be associated with marginalized people, with the limited physical assets and low skill, the government has tried to support them with some funds adopting rural credit system. Many of such programs have been initiated since early 1970.

Priority Sector Lending Program (PSLP) was adopted in 1974 as a financial instrument to increase production in particular sectors like cottage industry and services, agriculture. The objective was to increase the participation of the poor people in the economic activities through small level of investment. The commercial banks were instructed to invest, at least, 12% of their credit into this sector. The Intensive Banking Program (IBP) was initiated in 1981 to increase income of poor households by increasing production and employment of the poor people through credit as well as other services like trainings. By 2000, the intensive banking program has been providing the services in 357 locations, out of which 321 are based in the rural areas. In 1990, commercial banks were instructed to flow credit to the “deprived sector”, which was represented by the marginalized households (households below the officially defined poverty line). The deprived sector was supposed to receive 3% of the total priority sector lending. Due to these efforts, the commercial banks had been able to flow about Rs 9.95 billion rupees in the priority sector, which was about 13.8% of their outstanding loans as of January 2000 (Acharya et.al. 2002).

After the adoption of the financial liberalization, many private banks and joint venture banks have started operating in Nepal. These banks have always resisted on an attempt to flow credit to the rural sector. For example, credits are considered risk prone and profit reducing activities. Such mandatory credit system is considered against the free and liberal economic environment. As a process of liberalization, the priority sector credit program is, now, slowly withdrawn. This is considered as a negative process in an attempt of poverty reduction. The participation of the marginalized people in the economic activities with the credit flow has been successful to improve the rural economic status.

Another important aspect of rural credit is associated with micro financial services to the rural people. Many programs have been operated since 1975 to strengthen rural micro credit. The first program was launched in 1975 as the The Small Farmer Development Prgroam (SFDP). The program was started as a credit based poverty alleviation program involving small and poor farmers who owned or operated less than 0.5 ha of land, with the annual income less than Rs
2500. This organization was, later on, reorganized in 1993 into Small Farmers Co-operative Limited (SFCL) to make it less bureaucratized, locally owned, participatory and self reliant. With these structural changes, SFLC is found to be effective in:

- Increasing household assets and lead to increased savings
- Development of small irrigation systems, bridges, culverts and other infrastructure development
- Increased income of SFCL member due to milk production, livestock farming and other economic activities
- Improved accessibility of the poor to the institutional credit and rehabilitation of the ultra poor.

Based on the success of these initial programs, many other similar programs have been launched. Some of them are Production Credit for Rural Women (PCRW) Program, Micro Credit Project for Women (MCPW), Savings and Credit Co-operatives (SCCs), Rural Micro Finance Development Centre (RMDC) etc.

These programs have definitely high cost because of its social cost component. The interest based on the market is not sufficient to cover such social cost. When the program was launched for the first time, such extra cost was covered by providing subsidies and transfers by the government and the central banks. But after the adoption of liberal financial policies, such subsidies and transfers have been considered as “distorting” element of the operation of market economy. So, now, no subsidies and transfers are available for providing micro financial services to the rural poor (UNDP, 2003). The consequences of such decisions are obvious. Fund available to the poor people will be reduced or the cost of such services would rise. In both of these cases, the access to credit and other services for economic activities would reduce and available fund would be more expensive. These situations are not favorable for the poor people.

7.5.3 Financial Liberalization and Agriculture Sector

Liberal environment for financial activities means that the credit flow which will be directed to those sectors, that can generate more profit. There will be no other guidance as government priorities and instructions in the open and competitive environment. When liberal policies for the financial sectors were adopted, many new commercial banks, development banks, finance companies and cooperative came into existence. Before the adoption of liberal economic policies, there were only three joint venture banks operating with two national commercial banks. At present, there are 17 commercial banks. If there were only two development banks before financial liberalization, currently there are 17 such development banks. There was not a single financial company then, but now, there are 57 such finance companies in Nepal.

The increments in the numbers of these banks and financial institutions have significant impacts on the deposit mobilization as well as on credit flow.
The deposit mobilization increased nearly six times from Rs 33,328.6 Million to Rs 181,203.0 Million. While the credit flow also increased nearly five folds from Rs 31,794.8 Million in 1992/93 to Rs. 160,919.0 Million in 2001/02 (Fig.7.7).

Available data of Commercial Banks and Agriculture Development Banks show the distribution of credit in different sectors. The major sectors receiving loans from these commercial banks are industry, trade and consumption.

The agriculture sector, which is dominated by the poor people, is least catered by the Commercial Banks. The credit flowed to these sectors from Commercial Banks and Agriculture Development Bank is of Rs 2,667 Million, which is only about 2.4% of the total credit flow (Table 7.7) The share of agriculture in the credit flow in early years of financial liberalization is also nearly at this ratio. The industry sector is found drawing highest amount of credit, absolutely as well as relatively. The total credit flow was Rs 5126.9 Million in 1992, which increased to Rs. 48057.0 in 2001. As a result, the share of the industrial sector in total credit flow had increased to 44.1% in 2001 from 29.86% in 1992. The limited growth of credit in agriculture sector shows that during the decade’s long period of liberal economic policies, economic activities in the agriculture sector are not expanding very much. As the agriculture sector is the dominating sector of our national economy providing employment to about 78.1% of the population, limited flow of the credit to this sector indicates that there is not significant investment in this sector. As a result, the living standard of the people dependent on this sector is not improving. It implies that the incidence of poverty in Nepal is not declining.
### Table 7.7: Distribution of Credit to Different Sectors

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</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>2.48</td>
<td>2.28</td>
<td>1.80</td>
<td>1.80</td>
<td>1.83</td>
<td>1.82</td>
<td>2.1</td>
<td>2.2</td>
<td>2.2</td>
<td>2.4</td>
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<tr>
<td>(Percentage share)</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry</td>
<td>5126.9</td>
<td>6684.5</td>
<td>9630.5</td>
<td>16090.1</td>
<td>24703.4</td>
<td>29750</td>
<td>35796</td>
<td>4206</td>
<td>48057</td>
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<tr>
<td>(Percentage share)</td>
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<td></td>
<td></td>
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<tr>
<td>Services</td>
<td>506.7</td>
<td>741.9</td>
<td>1294.6</td>
<td>1635.7</td>
<td>2020.2</td>
<td>2337.7</td>
<td>2732</td>
<td>3374</td>
<td>4635</td>
<td></td>
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<tr>
<td>(Percentage share)</td>
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</tr>
<tr>
<td>Trade</td>
<td>6751.0</td>
<td>7007.6</td>
<td>9786.3</td>
<td>12748.5</td>
<td>21640.9</td>
<td>25659</td>
<td>28478</td>
<td>32199</td>
<td>37459</td>
<td></td>
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<tr>
<td>(Percentage share)</td>
<td></td>
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<tr>
<td>Consumption</td>
<td>4578.1</td>
<td>4369.3</td>
<td>5936.2</td>
<td>5588.5</td>
<td>6441.8</td>
<td>8363.3</td>
<td>8752</td>
<td>11877</td>
<td>13322</td>
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<tr>
<td>(Percentage share)</td>
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<tr>
<td>Miscellaneous</td>
<td>-</td>
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<td>-</td>
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<tr>
<td>(Percentage share)</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>17168.5</td>
<td>19241.7</td>
<td>27347.0</td>
<td>38779.3</td>
<td>50891</td>
<td>58378.3</td>
<td>68618</td>
<td>81759</td>
<td>96325</td>
<td>109922</td>
</tr>
<tr>
<td>(Percentage share)</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
<td>100.00</td>
</tr>
</tbody>
</table>

Source: NRB

The investment made through the finance companies are diverted to better off people because of the need of asset collateral for security. Due to the collateral requirements for security, the poor people have not been able to have access to the financial institution.

### 7.6 Case Studies and Microeconomic Evidence

#### 7.6.1 Carpet Industry

There is a rise in the export of a country mainly because of the enhancement of the competitiveness with a change in exchange rate. The convertibility of current account allows Nepalese rupee to depreciate. Nepalese products become cheaper and market expanded. As a result, carpet industry expanded rapidly during 1993-1994. This sector absorbed up to 500,000 labour during that period. It became an important source of employment and represented typical example of “comparative advantage”.

Carpet Industry is a major export item of Nepal in the current open economic environment. The export trend is declining as compared to the early 90's but it still covered as high as 33% of the total export to Third country (other than India) in the fiscal year 2001/2002. The share of the carpet export was about 20% of the total export of Nepal in the fiscal year 2000/01 (Fig 6.4), though in 1992/93, the share of carpet in total export was as high as 50%.

In 1993/94, 3325000 sq. meters of carpet was exported. In 2001/2002, the total carpet exported from Nepal was only 1693000 sq. meters, thus indicating the declining competitiveness of this industry. As a result, the earnings from carpet industry is found declining gradually (Fig 7.9).

The growth in the export of carpets in the beginning of 1990 might be due to the depreciation of the Nepalese currency and Nepalese carpet being the new type of products for the European buyers. The surge in the production of Nepalese carpets led to the increment in the supply of such carpets in the European market causing the reduction in price as well as change in the taste of the European buyers. These have been the causes of the reduction in the demand for the

2 These labour force indicates dyeing, washing, along with weaving, which is generally reported by the organized study.
Nepalese carpets. In addition some other countries with better knowledge and more efficient production system have taken the market of the Nepalese carpet.

**Figure 7.9: Carpet Export and Earnings in US $**

![Graph showing carpet export and earnings in US $]

Note: The data for 2002/03 is estimated


Carpet industry supports substantially to balance the trade of Nepal. The share of its value in total export highlights this fact. The share of the carpet was more than 50% during 1992/93. At the current deteriorating stage also, this industry is covering more than 15% share.

But the carpet has more importance due to its labour-intensive character. In its peak period of 1993/94, it was estimated to employ more than 500,000 labour. Now, this industry is employing only about 200,000 people. According to the estimates of the Carpet Association of Nepal, every ten square meter of carpet production will create employment opportunity for a labour. In the Nepalese context, where 300,000 people are added to the labour force every year, the importance of labour intensive industry like carpet is vivid. This industry requires skill and competence to weave and this characteristic is associated with the labour force of the Hills and Mountains, where incidence of poverty is very high. Therefore, the carpet industry is directly beneficial for poverty reduction in Nepal, because it will employ population living below the poverty line.

### 7.6.2 Foreign Employment

Growth of the foreign employment trend is an important economic event during the period of study. Nepalese people have a tradition of being employed in the foreign countries in foreign army, but, now, the outflow of Nepalese labour is very high in other sectors like manufacturing and services. These outgoing labours do not exhibit high level of skill. So they are involved in such level of activities, which are associated with unskilled or semi skilled level only.

In Nepal, the foreign employment has been a common phenomenon since early 19th Century, when Nepalese armies were attracted towards the British Army in India. It has, now, become a tradition. Many Nepalese people are employed in the British Army, Indian Army as well as in other countries like Hong Kong, Brunei etc. The practice of joining army in India during the British rule created further attraction to get jobs in India other than in army. Many people found opportunities to get a job in security service in industries, firms, individual houses as well as in small localities in India. This trend of getting employment was further strengthened, when Nepalese labour force moved to India and started to work in other sectors than security service.
Currently large number of Nepalese are engaged in India in small café, hotels and other service sectors.

The adoption of the liberal policies helped to identify market for Nepalese labour in the countries other than India. Liberal trade policies, expansion of the private sectors and encouragement of foreign investors magnified the visions of entrepreneurs. As a result, many manpower operation firms came into existence. Necessary legal changes are also made to support the activities of such firms. These firms have slowly succeeded to increase the supply of the labour force in Arab countries, far eastern countries like Malaysia, Singapore, and Korea. The available government statistics indicate the start of the process with 855 people being legally supplied to different countries by 1989/90. The process fully took its pace after 1993/94, and in 2001/02, 63,513 people are estimated to be going to third countries other than India to get employment (Fig 7.10).

**Fig 7.10: Foreign Employment in Countries other than India**

The growth of such foreign employment shows wide fluctuations especially during the early periods. However it shows tendency towards stability (Fig 7.11).

**Fig 7.11: Growth of Foreign Employment in Countries other than India**

*Source: Department of Labour*
But these are officially available statistics. It has been a common practice to avoid government channels for the foreign employment due to the hurdles like the restriction of the women labour to work in Arab countries, and the need of excessive documents and other bureaucratic hurdles. Manpower agencies also try to shun government procedures. Moreover, there is possibility of going to third countries via India, thus avoiding government regulations. Due to these reasons, it is estimated that the number of labour engaged in foreign countries are three times greater than that of government statistics. The total remittance received from official sources accounts to Rs 35,000 million from India and about Rs 32,000 million from overseas countries (Table 4.13). On the basis of number of Nepalese working in other countries, it is estimated that the remittance from other countries exceeds 100 billion per annum and increases each year both in number of employment and remittance.

As the cost of travel and other migrating cost to other countries are high, it is difficult for the poor to mobilize such fund and, in many cases, they borrow money at a very high rate of interest. The local moneylenders exploit the poor. These days, the banking institutions are also providing loan to the migrating Nepalese at low rate of interest. This provision has assisted the poor migrants to save their earnings, which they can use for productive purpose. The remittances have helped in changing the structure of income distribution within Nepal. Many of the earlier poverty-stricken sector people have become now the high income earning group of Nepal. It has helped in reducing poverty in the rural areas of Nepal.

7.7 National Policies for Maximizing the Equitable Distributional Impact of Trade and FDI

7.7.1 National Poverty Reduction Policies

With the adoption of liberal economic policies in late 90’s, the government also simultaneously tried to address the growing incidence of poverty by developing other policies, which could address poverty reduction. The Eighth Five Year Plan during the period of 1992-1997 adopted poverty reduction as one of its major objectives. In the beginning of the Eighth Plan, about 9 Million people were estimated below poverty line, which would be about 49% of the total population. To address this grave problem, the Plan emphasized the identification of poor people by adopting proper indicators. It was expected that such indicators would be able to depict the actual scenario of poverty in Nepal in terms of absolute numbers and their geographical concentration.

Some important policies chalked out by the Plan were as follows:

- Development of proper indicators of poverty
- Implementation of targeted programs for the poor people
- To raise the poor people’s access to the resources
- To raise awareness and formulate legal provisions to overcome unfair practices of the society
- Development of necessary institutional structures to support the poor people.

These policies indicate that there was not even clear definition of the poor people, nor were there any meaningful economic programs, which could address the problem of poverty. The
government was already on the path of the economic liberalization at that period, but no explicit linkage was built up between possible economic gains by the adoption of liberal economic policies and its impact on the poverty reduction.

At the end of this Eighth Plan, the population below the poverty line was estimated at 42%. Due to this limited success of the Eighth Plan, The Ninth Five Year Plan adopted poverty alleviation as its main objective to overcome the growing poverty level. It was targeted to reduce the poverty level from 42% to 32% by the end of the year 2002 with a long-term goal of reducing this to 10% within the coming 2 decades. In addition to these targets, several other variables related to the “human poverty” (literacy, infant mortality, maternal mortality, and average life expectancy at birth) as opposed to the “income poverty” have been identified, and target levels for each of these have been set.

The Ninth Plan intended to reduce poverty via

- Sustained and broad-based growth,
- Development of rural infrastructure and social priority sectors, and
- Specific programs targeting the poor.

Different plans and policies were formulated and executed during the decade of 1990s to achieve the objective of the poverty reduction. Some of the significant policies and their impacts on the poverty reduction are discussed below

7.7.1.1 Rapid GDP Growth

The Ninth Plan targeted growth of GDP by 6% during the Plan period. Such rapid growth was expected to be instrumental to bring down poverty level from 42% to 32% during the Plan. The share of agriculture was expected to rise by 4%, whereas the share of non-agriculture was estimated to increase by 7.3% during the Plan period, thus achieving the overall national growth of GDP by 6%. The industrial growth was expected to be based on comparative advantage, making it self-sustaining and market oriented. Commerce sector was also made fully competitive and market oriented, integrating with the globalization process. Due to these policies, it was expected to have rapid growth in non-agriculture sector.

Analysis of the GDP growth covering agriculture GDP (AGDP) and non-agriculture GDP (NAGDP) indicates that the growth target of the Ninth Plan was not achieved satisfactorily.

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Real GDP</td>
<td>5.06</td>
<td>4.84</td>
</tr>
<tr>
<td>Real AGDP</td>
<td>3.74</td>
<td>2.72</td>
</tr>
<tr>
<td>Real NAGDP</td>
<td>6.87</td>
<td>6.64</td>
</tr>
</tbody>
</table>

Source: Economic Survey (Various Issues)

The agriculture sector failed to keep the pace of its growth of 1981-1990 period after the adoption of liberal economic policies. Its growth was 3.74% in real terms during 1981-1990, but it slowed down to 2.72% during the period of open economic environment. Though the growth of non-agriculture sector also retarded during this period, the degree of retardation was much lesser in non-agriculture sector (Table 7.8).

The data indicate that the expected growth rate of the Ninth Plan was not fully achieved. Agriculture sector lagged behind after the adoption of liberal economic policies. As the
incidence of poverty is much higher in the rural sector, which is basically agriculture based, the slow growth rate of the agriculture sector indicates that the liberal economic policies are not pro poor in general.

7.7.1.2 Focus on Agriculture Perspective Plan

The government identified the role of agriculture in the poverty reduction. As a result, Agriculture Perspective Plan (APP) was adopted in 1996. Since then, it has become the major tool of the national planning. The policy complement with the open economic policies also encourages the private sector participation and allows the role of the market in the resource allocation process. At the same time, APP also maintains the role of the government to develop basic infrastructure development necessary for the agriculture development.

APP was implemented as a long-term plan with 20 years span. It was expected that per capita growth of agriculture would rise from 0.5% to 3% a year by the end of the APP. With the adoption of this Plan, the incidence of poverty was expected to decline from 42% in 1997 to 14% in 2015, which would have been only 29% without the adoption of APP. This agriculture policy adopted the objective of the commercialization of the agriculture sector from subsistence level through the realization of the comparative advantage. It was expected that price mechanism would be effective to transform agriculture sector from subsistence to the commercial level. It has thus got the essence of the liberal economic policies. The consequences of such commercialization driven by the price function would bring benefits to the farmers. As a result, poverty level would be reduced.

The current statistics do not confirm the expectations. Real agriculture GDP has not risen as expected. Many reasons are identified for such failure. Failure of price mechanism is the major cause. The price of basic agriculture products like rice, wheat etc could not rise to significant level. As a result, farmers involved in the production of these crops could not harness any benefit. The vicious circle is then prevailed; there has been low degree of commercialization, followed by low output, low income and so on.

But the fruits of the liberal economic policies are available for the urban population due to the urban bias trade pattern. The trade has expanded but is found limited to the urban sector. Liberal economic policies also drove export, but the major exportable items were without any backward economic linkages. Due to this effect of liberal economic policies, the fruits of the liberal economic policies could not be in the reach of the farmers in the rural sector. A closer integration of the agriculture sector with other sectors is necessary to make the economic growth suitable for pro-poor. The study of UNDP also indicates that, in the current process of economic growth, the direction of the program in Nepal is only moderately pro-poor.

7.7.1.3 Access of The Poor to Major Productive Assets and Services

There are many hindrances for the poor to come out of the poverty cycle. The limited access to productive assets like land is one of the major causes of poverty. The land distribution pattern of Nepal indicates that 43% of the land holders owning less than 0.5 ha. has access to only 11% of the total cultivated land, whereas the top 10% of households owning 3 ha. and more have occupied 42% of the total cultivated land. As the majority of the population own low holding of land, there is no opportunity to adopt commercial agriculture practices. The government has tried to regulate the distribution of land by adopting Land Reform Policies since 2000. But these reforms are not adequate to make a meaningful difference in agriculture.
The other important barrier to come out of the poverty level is related with education and skill. Poor people have no means to invest money for education. As a result, they will not be competent enough to get employment opportunities in non-farm sectors. The low education level also inhibits the opportunities for them to get skill trainings necessary for employment. The current literacy rate of 48.19% indicates that illiteracy is rampant with poor people. Moreover, the gender biasness is more acute in literacy rate with 34.5% literacy among the women in Nepal. Many attempts are made by the government to provide basic education to its citizens. Similarly the government is increasing training programs to enhance skill of the labour force. The attempts to raise human resources are vital to distribute the fruits of liberal economic policies among its citizens.

7.7.1.4 Fiscal Policies for Income Distribution

After the adoption of liberal economic policies, government promoted export oriented industries. Different types of fiscal supports were granted for such industries. Duty draw-back, zero VAT facilities etc are still provided to export-based-industries to be competitive in the international market. The export based industries enjoyed tax holiday till 2000. There was no tax on earnings of export. These tax incentives provided opportunities to the exporters to promote their products. The most recent tax policy also provided some facilities in income tax. Poor farmers are facing some negative consequences at present. Poor people in rural areas are facing first distinct problem due to the with-drawl of subsidy in different agriculture inputs like fertilizer. There was about Rs 600 million subsidy in fertilizer in 1990/91, but it was completely taken off by the government in 1999/00 (Table 2.13). The farmers found the price of agriculture input increased from Rs 6900 per M ton in 1993 to Rs 10,300 in 2000. Farmers faced similar problems in other agriculture inputs like seed, irrigation etc. Due to these changes, specially poor farmers faced hardships.

Changes in expenditure pattern during the post liberalization period also added further burden to the poor people. The development expenditure for basic social services like education, water

| Table 7.9: Development Expenditure on Some Social Sectors at the Base Year Price of 1994/95 |
|---------------------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|------------------|
| Education | 3955.479 | 4079.082 | 1453.6 | 1659.87 | 2036.4 | 1693.35 | 1251.95 | 1879.98 | 1982.85 |
| Annual Change in Percentage | 3.124848 | -64.3645 | 14.1903 | 22.68872 | -16.8489 | -26.067 | 50.16516 | 5.470734 |
| Health | 685.1598 | 598.1857 | 858.5 | 848.4708 | 1401.21 | 1725.769 | 1279.329 | 1553.47 | 1404.848 |
| Water Supply | 2079.224 | 1145.784 | 1118.72 | 1147.018 | 1388.196 | 1423.951 | 1769.905 | 1714.58 |
| Annual Change in Percentage | -44.8936 | -3.80389 | 1.440055 | 2.588908 | 21.02652 | 2.575645 | 24.29535 | -3.12871 |

Source: Economic Survey (Various Issues)

Supply etc is found declining at the constant price of 1994/95. In the education sector, it declined by 64% from fiscal year 1993/94 to 1994/95. There has been a decline in the education sector by 49.8% for a decade from 1992/93 to 2000/01. Similarly there is also a decline in water supply by 17.5% during the same period (Table 7.9). Such reduction of expenditure on key social services is definitely felt more painfully by the poor people. It thus shows that changes in fiscal policies are pro-rich during the post liberalization period.