A Glimpse of Inclusive Growth in Nepal

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Abstract

After the prolonged political transition and a decade long insurgency, Nepalese citizens got the historic opportunity to vote in the constituent assembly election in April 2008. The constitutional assembly abolished the Monarchy on May 2008, promulgated the new constitution on September 2015, and successfully completed the three tiers of the election in 2017. Nepal is now headed towards the single agenda of economic progress that needs inclusive high growth. Even though the government is able to achieve a 7.1% growth in the fiscal year 2018-2019 and planning to achieve a two-digit growth in the upcoming years, the inclusiveness of growth cannot be assured until the growth is broad-based and the increased prosperity equally shared with the bottom quintile of the population. This growth needs to create employment for all class of the people in the society. This can be possible by re-structuring the current land use pattern for agriculture and integrating the agriculture sector reform to that of tourism.

Key Words: Inclusive growth, Agriculture sector reform, Leasehold farming, Community based farming, Eco-tourism.

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Introduction

The political history of modern Nepal is almost 250 years old. It began after King Prithvi Narayan Shah conquered Kathmandu, Patan, and Bhadgaon in the Kathmandu valley and united Nepal’s eastern and western kingdoms during 1768-1790. After that, there were many ups and downs in the Shah dynasty.
until King Birendra and most members of the royal family were killed in a massacre on June 2001. The then Prince Gyanendra became the new King of the Himalayan kingdom. On February 2005, King Gyanendra took absolute power vowing to crush the Maoists and other political parties. The Maoist revolution that started in early 1996 had spread all over the country and claimed the lives of thousands of innocent Nepalese. However, the domestic, as well as the geopolitical situation, was not in the King’s favor. In April 2006, more than two million Nepalese came onto the streets and marched against the Shah dynasty and King Gyanendra was forced to give up the absolute power. Maoist came into the peace talks and signed on a peace deal that ended the decade-long insurgencies in the country.

In April 2008, Nepalese citizens voted in the historic constituent assembly election, in which Maoists emerged as the largest political party, that abolished the Monarchy from the country on May 2008. Nepal became a republic although the country had to hold another round of elections in 2013 to witness a successful constituent assembly. With the promulagation of the new constitution in September 2015 and the successful completion of the three tiers of election (local, state, and federal governments) in 2017, Nepal is now headed towards the single agenda of economic progress. Actually, the economic growth (the increase in the size of the economy), prosperity (the quality of growth reflected in terms of development), and inclusion (the distribution of growth fairly across society and creates an opportunity for all) are the hallmarks of the economic progress. Those three terms are positively related. The inclusive growth helps to eradicate poverty and keeps the inequality low in the country. Growth is required for prosperity as well as to eradicate poverty and to reduce inequality from society. However, the achievement of inclusive growth needs prudent policies.

The current government, in its formation, aimed to achieve an 8% economic growth in the fiscal year 2018-2019 and presented the more ambitious growth pictures for the upcoming years, albeit the country achieved only a 7.1% growth in that fiscal year. But that is still an encouraging achievement if sustained for a longer-term, especially for a country just emerged from a decade-long civil war and a prolonged political transition. The ambitious government plans are appealing to one of the least developed countries in the world with a per capita GDP measured at 2,443 constant 2011 international PPP dollars.

In 2011, about 25.2% population nationally and 27.5% population in rural areas lived below the national poverty line, set at $165 per person per year or $0.45 per person per day, a line set much below the international standard. Measured at the national poverty line, the incidence of poverty has been falling at an accelerated pace from 41.8% of the overall population in 1996 to 30.9% in 2004 and further down to 25.2% in 2011 (ADB, 2013). However, the income Gini of the country decreased only by a small margin to 0.328 in 2010 from 0.352 in 1995 and 0.44 in 2004 (WB, 2019).

Despite the significant progress made in achieving high economic growth in the most recent years and eradicating poverty in the past two decades, millions of people are yet to experience the benefits of economic growth. For instance, approximately five million people in Nepal are undernourished and for every 1,000 live birth, 53 still die before their fifth birthday (CBS, 2016). This is in part caused by limited access to farmland for impoverished households in rural areas, limited access to nutritious food, and lack of better access to health care and education for people in poverty and hunger. The highly fragmented land structure, the lack of year-round irrigation facilities, lack of knowledge on advanced farming methods, and the limited or
no access to market are the major causes of low agricultural productivity in rural Nepal (Devkota & Upadhyay, 2013).

On top of those challenges, most of the farmland in Nepal is owned by the upper and middle-class families. In recent decades, most adults from rural areas have also migrated internationally and moved their families to urban areas for a better future, abandoning their rural farmland. This increases the current problem of food shortage among the impoverished families in rural Nepal. Thus, a very specific and carefully designed land use policy is required to enhance the access to farmland for marginalized and poor families in rural Nepal. The increased access to farmland could enhance the employment opportunities for rural poor, improve the current economic growth, and redistribute part of the increased income into the hands of marginalized and poor families. High economic growth is considered as the most effective vehicle to eradicate poverty if the increased income is properly redistributed to the population below the national poverty line, i.e., bottom twenty-five percent of the population in Nepal. That could also be fruitful to increase access to nutritious food to rural poor and to eradicate hunger, and malnutrition from rural Nepal. This policy, therefore, provides ample opportunities to embrace low-income households into a more sustainable social security system. In total, a growth strategy, which can help achieve sustainable development goals is considered as inclusive growth.

In this context, this policy brief explores specific answers to the following three questions: (1) what kind of land use policy or agricultural sector reform policy is required to achieve the inclusive high growth in Nepal?, (2) could we integrate the agriculture sector reform with that of tourism for the sustainable development of both agriculture and tourism in the country?, and (3) what could be the combined effect of those changes on the economic growth of Nepal?

Recent Trends
In 1995, Nepalese government launched the Agricultural Perspective Plan (1995) as a 20-year vision and strategy for agriculture-led growth with aims to accelerate the growth rate in agriculture, alleviate poverty, improve the standard of living through accelerated growth and extended employment opportunities, and enhance commercial farming (NPC & ADB, 1995). That plan envisaged an additional 2%-point growth in the agricultural sector, i.e., agricultural growth to reach 5% from the current 3%. The population growth rate during the mid-90s in Nepal was 2.5%. APP 1995 assumed a 0.5% decline in population growth during the same plan period. Thus, that increase combined with a 0.5% decline in population growth, would be assumed to expand the per capita agricultural sector growth by six-fold from the 0.5% [3% - 2.5% = 0.5%] of mid-90’s to 3% [5% - 2.5% + 0.5% =3%] per year by the end of the plan period in 2015. However, Nepal was unable to meet those objectives by the end of the plan period in 2015. Unlike the targets, agriculture sector growth rate was increased from 2.9% to 3.1% (only a 0.2%-point increase) and the per capita agriculture sector growth expanded from 0.5% to 1.1% (approximately one-fold increase).

In 2014, Nepalese government launched another ambitious agriculture sector development plan, known as Agriculture Development Strategy (ADS) 2014 with the vision to develop a self-reliant, sustainable, competitive, and inclusive agricultural sector that drives economic growth and contributes to improved livelihoods and provides food and nutrition security in the country (MoAD/N, 2014). In order to achieve its vision, the ADS proposed to accelerate the agricultural sector growth from current 3.1% to 6.0%, reduce the percentage of the agriculture sector dependent population from current 66% to 30%, and
reduce the rural poverty from current 28% to 10% in the plan period from 2015 to 2030. To achieve these objectives, the government plans to intervene through four strategic components related to governance, productivity, profitable commercialization, and competitiveness. At the same time, the government designs policies to promote inclusiveness (social and geographic) and sustainability (both natural resources and economic) and encourages the private and cooperative sectors for increased investment in agriculture. Also, the importance of connectivity to market infrastructure (e.g., agricultural roads, collection centers, packaging facilities, market centers), information infrastructure and information and communication technology (ICT), and power infrastructure (e.g., rural electrification, renewable and alternative energy sources) are realized. Given the untenable performance of the Nepalese bureaucracy on the Agricultural Perspective Plan 1995, it would be hard to believe in the performance of the same institution again on the achievement of the targeted objectives of ADS 2014 despite the fact that ADS has envisioned for inclusive, sustainable, multi-sectoral, and connectivity-based growth. In addition, the highly fragmented land, lack of access to farmland for impoverished households in rural areas, and the severe labor shortage due to the international migration of adult population from the middle and upper-class families from rural Nepal are other prominent challenges to achieve the targets of ADS 2014. In the next two sections, agriculture and tourism sectors reform policies to achieve the broader objectives of ADS, in particular, and to achieve the inclusive sustainable high growth in the country, in general, are discussed.

Proposal for Reform

Based on the best usability of the land, the Nepalese government has initiated a land zoning policy since 2018. Despite the efforts on land zoning, the government will be unable to meet its objectives set by ADS 2014 given the sub-optimal land distribution and the unavailability of adult human capital in rural areas in Nepal. This policy is progressive towards the achievement of the ADS 2014 but this is not enough. That raises an obvious question—what could be the additional policy(s) to achieve the broader goals set forth by ADS 2014?

Nepal was one of the food-exporting countries until the 1970s but is one of the net food-importing countries in recent decades (Baral, 2000; Pyakurryal et al., 2010). Approximately, 29% of its land is arable (WB, 2016). There are altogether 6,000 rivers (including rivulets and tributaries) in Nepal and the total renewable water resource of the country is estimated to be 237 kilometers cubed per year (km3/year) (WEPA, 2019). Even with these natural gifts, the scale of food insecurity faced by Nepal is exceptionally dissatisfying.

Despite this food scarcity situation in rural Nepal, agricultural land has been abandoned or underutilized in recent decades at an unprecedented rate. This trend has escalated over the past 20 years or so when the country experienced a nation-wide Maoist war which led to the political transition and instability (Paudel et al., 2014). That political transition and instability led to the international migration of rural youth and the migration of rural middle and upper-class families into the urban areas for a better and safe life leaving their marginalized and poor neighbors vulnerable in the rural villages. Those who are left behind at the rural villages do not have or have minimal access to farmland. To tackle these issues of lack of access to farmland and food scarcity, and to increase land productivity, Nepal needs a new land use policy. In this note, I propose the following two mass scale farming methods as a new agricultural land use policy.

Leasehold Farming: In this farming technique, the land will be leased by an enterprise. The
terms of the lease may vary. That may be a year-to-year lease, multi-year lease, rolling or renewable lease, lease with an option to buy or a right of first refusal, and/or transfer by sale of some or all of farmland over the short or long-term. Shorter term agreements can be more attractive to the beginners or early stage farmers but if they succeed, they can go for a long-term or a rolling leasing contract. But the long-term land lease has numerous benefits that range from tax incentives from the government to subsidized low interest agricultural loan by the banks to the investment on the leased land for the lessee for better productivity. In the long-term, the land lease is done for 25-35 years period and most of the time those are renewed before the termination of the first contract. In this farming model, the person or a group of people who leases the land has the right to use the land and build structures on it until the end of the lease term. These leases require the owners to farm, pay a low yearly rent, and share a percentage of any proceeds to the owner. The original landowners may periodically inspect the property to make sure it is being farmed, and all the structural additions are justifiable and approved by the local government.

The commercial banks or the agricultural development bank or both can finance the leasehold. In addition to the regular qualifications for obtaining a loan, the banks can set additional requirements such as the term of the lease can be at least 5 years longer than the term of the mortgage. Therefore, to obtain a 25 years mortgage the banks require a lease of at least 30 years in length. Thus, in this model private investor can borrow and invest in agriculture.

**Community-Based Farming:** Community Based Agriculture (CBA) can be defined as a community of individuals (farmers) who promise to a farm operation so that the farmland becomes, either legally or spiritually, the community’s farm, with all farmers providing mutual support and sharing the risk and benefits of food production on the basis of the share of their land in the total community land. Farmers forming the community share the cost and benefits of productions. They also share the risks of farming, including poor harvests due to unfavorable weather or pests. They act as a group enterprise. It is also a form of leasehold farming with a group of farmers as the shareholders of the enterprise.

**Benefits of Reform:** Both of those land use policies lead to mass scale farming, increase land productivity, enhance the growth rate of the agricultural gross domestic product (AGDP) and create employment opportunities in the rural areas specifically for less educated rural villagers. The growth rate in the agriculture sector has both forward and backward linkage effects. Those effects will have a multiplier effect on the economic growth of the non-agricultural sector. In addition, those farming models allow entrepreneurs to acquire farmland at a very inexpensive rate and construct additional infrastructures and invest in modern technologies which will cumulatively contribute to improve land productivity. This model further helps the government to design appropriate policy to provide tax advantages and other subsidies to the investors. Those policies help enhance efficiency in agriculture and multiply the growth of the agricultural sector.

The increased agricultural, as well as non-agricultural sectoral growth could multiply the employment opportunities to the less educated and impoverished rural poor. That could automatically help to diminish rural poverty, reduce income inequality and achieve sustainable development goals. The governments can impose a tax on income earned from new farming modules that they can use to provide social security income and health insurance at farmer’s retirement age. That way, the government can sustainably finance for social security and universal
Integration with Tourism: Contributing Rs. 177 billion to the national economy in 2016 alone, tourism has emerged as an integral part of national economy. The hotel industry has provided employment opportunities to more than 500,000 people (Sharma, 2017). According to the World Travel and Tourism Council (2017), the total contribution of travel and tourism to Gross Domestic Product (GDP) was 7.5% in 2016 and is expected to increase to 8.3% in 2027. This is possible if tourist flow doubles in the next nine years.

There is a huge scope for growth of tourism in Nepal. Nepal is endowed with beauty, and the very terrain that impedes other economic development is one of the world’s greatest tourist destination. From a slow beginning in the late 1950s, modern international tourism has become a government-encouraged industry, which, by the late 1970s, stood as Nepal’s number one source of foreign exchange (IBRD, 1979); one of the most lucrative attractions for Nepalese private investment (Blaikie et al., 1980); the foremost recipient of loans from the government’s Nepal Industrial Development Corporation; and a prime factor in maintaining Nepal’s unsteady balance of trade (IBRD, 1979).

Tourist numbers have increased dramatically in the past 50 years—from nearly 18,000 in 1967 to 940,000 in 2017. That number was nearly 163,000 in 1980, 254,000 in 1990, 463,000 in 2000, and 600,000 in 2010 (NTB, 2017). Government policies such as a loosening of visa policies; the opening of previously restricted mountain areas to trekking; development of a national park system; investment in the creation and continual improvement of an international airport; loans for hotel and restaurant development; and the permitting of gambling in a luxurious hotel in Kathmandu (Smith, 1981) in early 70’s and 80’s played vital role in this boom since 1980. Additionally, many other factors have contributed to tourism in Nepal. For instance, Nepal has 125 castes and ethnic groups who speak 123 different languages; it is the garden of flowers of different species; people with distinctive religions such as Hinduism, Buddhism, Islam, and Christianity are living within the same society in harmony; and Nepal is the home of 10 UNESCO world heritage sites (UNESCO, 2019). As Nepal is the birthplace of Buddha, believers of Buddhism highly care about the Buddhist shrines and love to travel those holy places (Barahi et al., 2017).

Development of an eco-tourism with new trekking routes and better homestay services in rural villages can greatly help to attract more tourists. Further, the integration of tourism with agriculture sector can create a significant backward linkage effect on employment as well as in the agricultural productivity. This policy also encourages the Nepalese farmers to produce agricultural products that tourists demand, for example, organic foods. This will help generate additional revenue to the farmers. The increased number of tourists will automatically increase the demand for food. That will encourage domestic producers to produce more to meet the increased need. At the same time, it can create additional employments in both sectors. That helps to reduce rural unemployment and eradicate rural poverty.

**Effect on Economic Growth**

*Data:* Data required to analyze the effects on economic growth were collected from three different sources. Those include the Economic Survey of Nepal 2017, the Quarterly Economic Bulletin, published in the first quarter of 2018, Nepal Tourism Statistics 2017, Tourism Employment Survey 2014, and the World Development Indicator 2019 (WB, 2019). To estimate the effect of agricultural and tourism sectors reform on economic growth GDP and
investment data were collected and analyzed from 2000-2016 for sixteen years period.

Method: To study the impact of those policy reforms on economic growth, I have used the following five steps methodology. First, based on the average performance on economic growth and investment in the past sixteen years, I calculate the incremental capital-output ratio (icor). Growth rates for the year 2002, 2015 and 2016 are low and the incremental capital-output ratios for those years are pretty high. Thus, I replace those icors by the three years moving average icors and calculate the average icors for that sixteen years period. Second, I use the Harrod-Domar formulation and quantified the investment required to achieve the targeted rate of growth at the given icor. Third, I explore the financing gap to achieve the targeted level of growth in the country. Fourth, I use Solow’s growth model to explore the potential challenges to achieve targeted growth in the country. Fifth, I estimate the impacts of policy change on agriculture and tourism sector on the economic growth of the country.

Results: Based on the past 16 years’ data, the incremental capital-output ratio is 5.4. Even though the data for the depreciation rate is not available, this research assumes that the country’s depreciation rate is 1.5%. At this icor and the depreciation rates, Nepal needs to invest 51.3% of its GDP for development activities to achieve an 8% growth in the country. With the average saving rate of 34.6% for the same period, the country faces a 16.7% financing gap to achieve the targeted growth. Thus, in the current situation, the 8% growth is pretty much impossible. Nevertheless, if the government is able to increase the current agricultural sector growth (3.1%) by 2% points that will create the multiplier effect of 1.5 in the non-agricultural sector (Janvry & Sadoulet, 2016) and adds another 4.5% of growth in that sector. Adding that 2% extra growth in current agricultural sector growth and that 4.5% extra growth in the current non-agricultural sector growth (7.7%), and taking the weighted average of the two, the national economy can grow by 9.5%.

Tourism: Based on the Nepal Tourism Statistics 2017, average time of stay of each tourist is 12 days (approx.) and the average spending is USD 54/day. That way, a tourist on an average spends USD 648. If Nepal can increase the number of tourist flow by 150,000 each year, that will add a 0.3% extra growth on the national economy. That is the direct effect of tourism on economic growth. That will also create an indirect effect on employment creation in the tourism industry and a multiplier effect on all other sectors including agriculture. If the cumulative indirect effect is equal to 0.1% of the national economy, the tourism industry can add a value of 0.4% on national economic growth which is still less than the predicted contribution of tourism industry on the economic growth of Nepal by travel and tourism economic impact 2017 (WTTC, 2017).

Total Effect: Combined, the agricultural sector reform with that of tourism sector reform sustainably increase the economic growth rate from the current 4.2% to 9.9% in Nepal.

Policy Discussion
As the agricultural land is heavily fragmented in Nepal, doubling the agricultural production (even the increase in agricultural production at least by a 2% points) without an innovative change in land use pattern is impossible. In that sense, if the government restructures the current land use policy by implementing the community based agricultural farming or leasehold farming or both at the same time and integrates the agricultural sector reform to that of tourism sector, Nepal can easily increase its agricultural sector growth from the current 3.1% to 5.1% (increase by 2%) and sustain the growth. As discussed in the previous paragraphs, this policy helps to achieve a 9.5% growth rate in the country. In addition, if the tourism sector reform can
attract another 150,000 tourists each year, that could generate an extra 0.4% growth in the national economy. Adding the effect of agricultural sector reform to that of tourism sector reform, Nepal can achieve a cumulative 9.9% growth rate in the upcoming years with those policies reforms. If the government at the same time is able to enhance the technology use and reduce the corruption rate at least to that of the Indian standard (out of 175 countries, Nepal ranks 124th least corrupt country vs. India 78th on corruption perception index 2018), the country can easily reduce its icro to 5 or less and comfortably achieve the two-digit growth at the most recent saving rate of 43.5% in the last 5 years.

This policy also helps enhance the employment of the illiterate and school dropouts in the agriculture and tourism sectors and takes those people out from poverty. Further the new policy helps reduce the school dropout rate and enhance the school enrollment rate, enhance the utilization of medical services, reduce the mortality rates, and enhances the life expectancy at birth. It could help provide better access to the pension system to all groups in the country. This policy, thus, helps to promote high growth and leads the country towards prosperity. It provides the fruits of growth to each class of the society, as a result, such growth becomes inclusive. However, to sustain this pattern of growth for a prolonged period of time, investment in agriculture and tourism alone is not enough. Nepal has to optimize the allocation of its limited resources in the different sectors of the economy.

Conclusion
Nepal government has to implement community-based agriculture farming or leasehold farming or both throughout the country and integrate that change with the tourism sector reform for the commercialization of agriculture. In the meantime, the country has to optimally allocate its limited resources in the different sectors of the economy. That could lead to 9.9% or even a two-digit growth sustainably. With the sustained two-digit growth, the per-capita income of the Nepalese people can be doubled in every seven years and reached to USD 14,000 or more and the country becomes the high-income country by 2040-2045.

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