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**GLOBALIZATION AND SUSTAINABLE HUMAN DEVELOPMENT:
AN ASSESSMENT OF CHALLENGES FACING NEPAL**

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**PARTNERSHIP ON
GLOBALIZATION,
LIBERALIZATION AND
SUSTAINABLE HUMAN DEVELOPMENT**



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The views expressed by the author do not necessarily represent those of UNCTAD or UNDP.

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The views expressed by the author do not necessarily represent those of UNCTAD or UNDP.

¹ The four studies are: Pushkar Bajracharya, *Sustainable Human Development in Nepal: An Assessment*, January, 2000; Binod Karmacharya, *Nepal's Integration with Global Economy and Its Impact on Sustainable Human Development*, January 2000; Rabindra Shakya, *Development Policies and Institutions and Their Impact on SHD*, January 2000; and Minendra Rijal, *Globalization and Sustainable Human Development in Nepal: Appraisal and Policies*, January 2000.

EXECUTIVE SUMMARY

State of Human Development

1. The 23 million people of Nepal, a least-developed, land-locked Asian country, have a very low average level of human development. The *Human Development Report* 1999 of the UNDP ranked it 144th in terms of the human development index (HDI) among the 174 countries that it covered. According to the World Bank estimates, covering 209 countries for the reference year 1997, Nepal ranked 201st and 189th respectively in terms of per capita GNP at the dollar conversion rate and purchasing power parity dollar. Life expectancy, at 57.3 years, is lower than in the neighbouring South Asian countries, but substantially higher than the average for the least-developed countries. Adult literacy rate, at 38.1 per cent, is lower than the comparable rates in both South Asia and the least-developed countries. Women in Nepal have a lower average level of human development than men according to all known indicators. Nepal and Uganda are the only countries for which women have a lower life expectancy than men. The desperation of the poor to eke out a living by whatever means are feasible and bad resource management have caused widespread degradation of the environment, e.g., the erosion of topsoil and deforestation.

2. Nepal's long-term progress in human development has been very mixed. The HDI for Nepal has increased at an annual rate of 2.2 per cent between 1975 and 1997, a faster rate of increase than what its South Asian neighbours have achieved. During the same period, the growth rate in per capita GDP was only 1.6 per cent, significantly lower than what the rest of South Asia achieved. In terms of the non-income components of human development - life expectancy, infant mortality and primary school enrollment - Nepal's *rate of progress* over the same period was faster than that for South Asia. Evidence on trend in poverty is not unambiguous. The distribution of income appears to have become more unequal over time. The stagnation in rural income, along with the increase in inequality, almost certainly has led to an increase in poverty in most rural areas with the possible exception of areas in the Kathmandu valley. In urban areas the growth in income was more significant so that, despite increased inequality, some reduction in poverty over the long period was actually achieved. Progress in reducing the gender imbalance in development has been slow and the deterioration in environment has not been arrested.

Integration with the Global Economy

3. Two factors have powerfully influenced the pattern of trade and industries in Nepal. First, the nearest port for access to the world economy, other than Nepal's immediate neighbours, is more than 900 kilometers away from Nepal's border. The access to ports has been expensive and time-consuming due to the undeveloped infrastructure in neighbouring India and Bangladesh. Secondly, Nepal is surrounded on three sides by India with which it has an open border. Together these factors put Nepal in a state of *de facto* free trade with India. Historically Nepal has granted free access to Indian goods ever since its first agreement on trade and transit with British India in 1923. But more than the formal provisions of trade treaties, the open border with India and the high cost of access to the markets of the rest of the world have been the decisive factors in putting Nepal in this situation of *de facto* free trade with India. Any attempt to create trading relations with the rest of the world through standard instruments of trade policy, e.g., tariffs and export subsidies, would, beyond a point, be thwarted by unofficial and unrecorded movement of goods and services across the open border with India.. The free trade with India was of dubious benefit to Nepal because India's economy was characterized by widespread and arbitrary protection creating a great deal of inefficiency in its structure of production and trade and Nepal could not resort to traditional methods of protecting its legitimate infant industries from competition from Indian producers.

4. Nepal therefore had nothing to lose by extending its *de facto* integration with India to a full integration with the global economy. While this by itself would not enhance Nepal's ability to promote worthwhile infants, it would at least prevent the transmission of the consequences of the distorted structure of production in India. The paradox, however, is that Nepal's ability to integrate with the global economy itself is limited by India's integration with the latter. Nepal took important steps for the liberalization of its economic policies under the Structural Adjustment Programme (SAP) initiated in 1986; but the opportunity for dramatic reforms for integration with the global economy came only in the early 1990s when India started opening up to the global economy in a big way. Principal elements of these reforms included the following: (a) the elimination of quantitative restrictions on imports; (b) rationalization of the tariff structure by a drastic reduction of the average rate of tariff and the number of tariff rate slabs; (c) a sharp reduction, though not a complete elimination, of discrimination against exports; (d) introduction of partial current account convertibility of the Nepalese Rupee (NR); (e) a broad range of measures to attract foreign direct investment (FDI) including the guarantee for the repatriation of return on investment in convertible currency, tax incentives and a rise in the proportion of stocks of companies that can be owned by foreigners. Together these measures - along with the reduction of price and distribution control, elimination of control over interest rates, reduction of fiscal deficit, and privatization of state-owned enterprises implemented under the SAP - radically altered the incentive structure in Nepal away from

the past regime of import-substituting industrialization (ISI). The reforms, in terms of opening up to the world economy, as measured by the weighted mean tariff rate, have gone much further than the reforms in India.

Effects of Integration with the Global Economy

5. Quite apart from the general problem of isolating the effects of any given set of economic policies from the myriad of other events, ascertaining the consequences of Nepal=s integration with the global economy on the various components of sustainable human development is complicated by the relatively short time period that has elapsed since the implementation of reforms and the unsatisfactory state of statistical information.

6. *Volume and pattern of trade.* There was a distinct rise in the ratio of exports to GDP in the post-globalization period although the upward shift in the ratio began prior to the implementation of major reforms related to the trade regime. The ratio of imports financed by export earnings has increased in the post-globalization period. The rise in the export/GDP ratio was due mainly to a rise in the export of services, which itself is largely a reflection of the peculiar accounting practice which shows the import of gold, financed by income remittance made by Nepalese workers abroad, as export of services. The rise in merchandise-export/GDP ratio was modest; although this ratio was higher in the mid 1990s than in the 1980s, its rise was not sustained after the implementation of the major reform of the trade regime. Over time Nepal=s merchandise exports have become less diversified with an unhealthy concentration in carpets and garments. The proportion of Nepal=s exports destined to India has increased during the post-globalization period partly due to the improved access permitted by the 1996 Trade Treaty and partly due to the reduced gap between the incentive for exports paid for in hard currency and the incentive for exports paid for in Indian Rupee (IR) as a result of the opening up of both the economies. Despite Nepal=s membership of the South Asian Association for Regional Cooperation (SAARC) from its inception, Nepal=s trade with the other South Asian countries is virtually non-existent. Nepal=s international competitiveness has been adversely affected by the significant appreciation of the NR relative to the IR in the post-globalization period. All the policies to attract FDI amounted to no more than a modest increase in its flow.

7. *Growth.* Arguably, the initiation of reforms led to a brief period of higher growth. There is, however, little evidence that the intensified reforms in the early 1990s had a sustained positive impact on growth which sharply declined since 1995/96, shortly after the conclusion of reforms. The decline in the growth rate was particularly sharp for industries and services. It appears that weak response of trade to reforms led to a weak impulse for the growth and restructuring of domestic production. The abolition of the protection vis-a-vis the non-Indian markets exacerbated the

problem of competitiveness in the absence of offsetting policies for the promotion of infant industries. This was reflected in the decline in the growth rate of industrial production. Agricultural stagnation became hard to reverse due to the rise in the cost of modern inputs that was largely brought about by the integration with the global economy. There was a limited rise in the rate of investment which was not reflected in a corresponding rise in the rate of growth of output. There was no rise in the rate of domestic saving. The rise in the rate of investment was not powerful enough to bring about a change in the supply/demand balance for foreign exchange that would prevent an appreciation of the NR relative to the IR.

8. *The distribution of income and the incidence of poverty.* The causal relation between globalization on the one hand and the distribution of income and the incidence of poverty on the other is even harder to ascertain due to the ambiguity of evidence on such things as the change in the level and composition of employment. The distribution of income during the post-globalization period appears to have become more unequal and this appears at least partly due to changes related to globalization. Thus, for example, the rise in the price of food, due to the change in the trade regime, appears to have had a more adverse effect on the welfare of the lower income groups than of the higher income groups. The failure of some industries, developed in the hot-house system of incentives under ISI in the past, to be competitive in the period of globalization, led to a fall in employment in the organized sector of the economy. Increased inequality and the slow growth of agriculture contributed to an increase in poverty in rural areas with the possible exception of the rural region surrounding the prosperous Kathmandu valley. The poverty-reduction potential of the more significant urban growth was substantially offset by the rapid rise in urban inequality.

9. *Other effects.* The process of globalization has so far failed to reduce the disadvantage that women suffer. Arguably, the pattern of development in the post-globalization period has aggravated the disadvantage suffered by women. It has also failed to reverse the process of environmental degradation. Indeed the exacerbation of rural poverty in the period of globalization may have further aggravated the problem of land degradation.

Policies for Sustainable Human Development in the Age of Globalization

10. Despite the questionable performance of its economy in the age of globalization, Nepal does not have the choice of reversing the process of its integration with the global economy. The consequence of reverting to the protectionism of the past will merely put Nepal back in the state of *de facto* integration with India which will be an inferior outcome as compared to a meaningful integration with the entire global economy. Furthermore, failure of globalization to promote SHD in Nepal was not so much due to the reforms for integration *per se* as to the inadequacy of complementary policies to enhance supply elasticity and to offset some of the adverse outcomes that

are specifically due to the unsatisfactory initial circumstances. By a substantial broadening of the reform programme and by cooperative action in partnership with its South Asian neighbours, Nepal can find a way of translating its integration with the global economy into higher growth and SHD.

11. *Overcoming the disadvantage of being landlocked.* One of the reasons that Nepal=s reform of the trade and investment regime has so far not had a stronger impetus for growth in trade is the high cost of transit to the ports from which it can access markets beyond those of its immediate neighbours. This can only be removed by the creation of a well-developed network of transport, port and administrative infrastructure in Nepal and in India and Bangladesh, a task that needs to be approached within the framework of regional cooperation among these countries. Guaranteed transit right can not by itself accomplish this.

12. *Regional cooperation.* Nepal=s cooperation with regional neighbours is essential for reasons beyond the removal of the disadvantage of its landlocked location. Growth of trade with its regional neighbours, through the creation of something like a SAARC Free Trade Area, is the natural route to a full integration with the global economy. Such a regional trading bloc, created by the removal of (currently often invisible) trade barriers and the development of transport and trade infrastructure, would have a strongly positive incentive on FDI inflow which is inhibited by the small size of Nepal=s domestic market. The 1996 Trade Treaty with India, which provides an opening in this direction, needs to be backed by adequate infrastructure facilities both in Nepal and in India. Cooperation between Nepal and its neighbours could profitably extend beyond trade and investment to the development of infrastructure, e.g., the exploitation of hydroelectric potential, by overcoming major indivisibilities that are involved.

13. *Improving the supply elasticity.* Nepal faces the difficult problem of promoting its infant industries in the face of competition from comparatively developed Indian industries across its open border with India. This must be accomplished by a combination of the supply of skills, inputs, infrastructure and targeted and time-bound support. The task amounts to the creation of comparative advantage in specifically targeted goods and services by learning from successful examples such as that of the Republic of Korea. Initial promotion might consist of the provision of an information network to help identify the market; publicly-funded research for product development; and the provision of production and marketing infrastructure. Further support should be tied to actual export performance and consist of easy and inexpensive credit and other fiscal incentives. Tourism; the two largest exports, viz., carpets and garments; handicrafts; new exports, e.g., selected electronic assembly developed on the basis of some kind of Agreed specialization≡ within the SAARC; and traditional exports, e.g., jute and leather products are some of the high-priority sectors that deserve attention and support. Garment exports are likely to face a serious problem of competitiveness once the MFA is discontinued in the near future. For Nepal to be able to cope with this, the

discontinuation of the MFA needs to be accompanied by the granting of zero-tariff status by the advanced importing countries to garment and other exports from the least-developed countries. In addition Nepal needs to resort to some of the support measures outlined above.

14. *Exchange rate.* The appreciation of the NR relative to the IR reflects the more favourable supply-demand balance for foreign exchange in Nepal than in India. Low demand for foreign exchange in Nepal, given its foreign exchange earnings and the relatively large inflow of foreign capital, principally in the form of ODA, is a reflection, among other things, of low investment. Demand for investment in turn is limited by low international competitiveness. Low international competitiveness is due, among other things, to the appreciation of the exchange rate vis-a-vis the currency of its giant neighbour. An effective way to break this vicious circle is to create competitiveness for enough worthwhile infants by a system of promotion outlined above.

15. *Membership of the WTO.* Nepal has applied for full membership of the WTO. This by itself will not have a significant effect on its integration with the global economy. But it will allow Nepal to seek arbitration should its rights - e.g., free transit and protection from dumping - are infringed. Even this is a limited advantage because of the high cost of seeking arbitration. The true benefit of full membership will consist of Nepal=s full participation in collective negotiation to preserve the flexibility on the part of the least-developed countries on a variety of issues related to globalization, e.g., the right to provide limited and time-bound support to industries and exports.

16. *Dealing with the adverse effects of globalization on SHD.* There are reasons to believe that Nepal=s continued integration with the global economy will have certain adverse effects on components of SHD during the period of transition. Many of Nepal=s existing industries, developed under the incentive system of ISI, incorporate numerous inefficiencies. One particular form of this inefficiency is employment of labour in excess of requirement. This problem is particularly serious in public sector enterprises. As a result of the opening up of Nepal=s industries to international competition and the gradual transfer of public sector enterprises to private ownership, the concealed unemployment in these industries will become open. This process will be exacerbated by the closure of enterprises that fail to remain profitable in the radically different incentive environment. The detrimental distributional consequence of this process can be offset by: an improvement of the growth rate and transitional measures such as public works programmes for the construction of infrastructural capital. A second transitional problem relates to food prices which were suppressed in the past by distortionary policies. The removal of these distortions may have adversely affected the rural poor because of the inegalitarian structure of the agrarian economy that results in a high incidence of net buyers of food among the poor. The first best solution undoubtedly is to dismantle the distortions with a simultaneous improvement in the access of the poor to land. Even if the latter is not feasible, it should be possible to design some action to compensate the net buyers of food

among the poor by an expansion of employment through public works or other forms of targeted support. The adverse effect of the upward shift in the prices of agricultural inputs should be countered by the introduction of compensatory measures to preserve the profitability of agricultural production. These measures should focus on an easier access to credit, an improved provision of extension services and an improved infrastructure for the marketing of output.

17. *Other policies for SHD.* Integration with the global economy has had and will have (hopefully modest) detrimental effect on income distribution and poverty. Offsetting policies outlined above may be able to compensate for these adverse effects. It is however desirable to consider additional action, directly unrelated to globalization, to promote greater equity and poverty reduction. An obvious policy of this kind is a comprehensive land reform which has so far not been implemented in Nepal. This report argues that the experience of successful land reforms in Asia indicates that Nepal=s rural economy could combine higher growth and greater equity by implementing such a reform. On the other hand, Nepal is far from satisfying the conditions that enabled these countries to implement their reforms. One way to get close to the satisfaction of these conditions in Nepal would be an injection of large external resources specifically targeted to implement a comprehensive land reform. A second set of policies, concerning the redistribution of *incremental assets*, should focus on the access of the poor to human capital, microenterprise, credit and rural infrastructure. Nepal has done well in preserving the share of education and health in public expenditure during the period of globalization. This needs to be continued with an emphasis on the improvement of the quality and quantity of these services to which the poor have access. Fiscal incentives to local communities and NGOs for the development of community level safety nets for those among the poor who are unable to benefit from programmes for employment and microenterprise is another area of priority action. All the policies for the protection of the poor and the vulnerable groups should have a specific focus on the protection of women. Improved condition of the poor, especially a greater stake for them in access to land, should help prevent the degradation of land. This should be supplemented by a broad range of microeconomic policies and investment programmes for the protection of Nepal=s environment.

18. *Specific support from the UNCTAD and the UNDP.* Nepal=s integration with the global economy with SHD amounts to a massive agenda incorporating national action, regional cooperation and the cooperation of the international development community. There are important ways in which the UNCTAD and the UNDP, the agencies which have launched the Global Programme on Globalization, Liberalization and SHD, can assist Nepal in this transition. Two obvious areas of such action are: the creation of a statistical system for the monitoring of income distribution, poverty and different components of human development; and the enhancement of Nepal=s capability in trade promotion, trade negotiations, negotiations with multinationals and other technical aspects of the process of globalization.

I. INTRODUCTION

19. Nepal is one of the "least-developed" countries of Asia. It faces a complex development problem which is aggravated by its being landlocked and separated from the nearest port by a distance of more than 900 kilometers. Existing system of transit and transport is difficult, time-consuming and expensive.

20. According to World Bank, 1999, it ranked 201st and 189th respectively in terms of per capita GNP at the dollar conversion rate and per capita PPP\$ GNP in 1997 among 209 countries that it reported on. In terms of a broader indicator of relative development, its performance was only slightly better. The United Nations Development Programme (UNDP), 1999 ranked it 144th in terms of the human development index among 174 countries that it reported on.¹

21. Like most developing countries, Nepal has been a participant in the on-going globalization process that has characterized the world economy in recent decades. Especially during the last decade, Nepal has instituted widespread reforms and changes in its economic policy to promote a rapid integration of its economy with the globalizing world economy.

22. The purpose of this paper is to: (a) analyze the nature of Nepal's integration with the global economy; (b) determine its effects on sustainable human development in Nepal; and (c) suggest policies for sustainable human development in Nepal as its integration with the global economy continues to progress.

22. Section II of this paper provides a brief summary of the state of human development in Nepal. Section III outlines Nepal's progress towards an integration with the global economy. Section IV tries to determine the effects that Nepal's integration has had on different components of sustainable human development in the short time that has elapsed since the country has been pursuing policies for greater integration with the global economy. Section V considers policies for sustained human development in the period of continued and intensified integration with the global economy that lies ahead. The final section discusses the role of the UNCTAD and the UNDP in assisting Nepal's integration with the global economy with sustainable human development.

II. THE STATE OF HUMAN DEVELOPMENT²

23. Human development can be defined to include as many facets of human capability as can be meaningfully analyzed with available data. For the present purpose, human development focuses on five distinct aspects: (a) growth of the economy; (b) expansion in major non-income indicators of living standard, e.g., life expectancy, education and health; (c) the distribution of income and the incidence of poverty; (d) gender balance in development; and (e) protection of environment.

24. Nepal enters the new millennium with a population of 23 million of which more than 20 million reside in rural areas. Nepal's population at the turn of the millennium has a very low level of human development according to all its components. For 1997³, the most recent year for which data are available at the time of writing this report, per capita GNP was \$220 and PPP\$ 1,090 which, as noted above, are among the lowest in the world.

Table 1
Increase in Human Development and its Components in Recent Decades
in Nepal, South Asia and Least-Developed Countries

	Nepal	South Asia	Least Development Countries
Annual % Rise in HDI (1975-97)	2.2	-	-
Annual % Growth in Per Capita GNP (1975-95)	1.6	3.7	2.3
Increase in Life Expectancy between 1970 and 1997 (years)	15.2	13.7	8.3
Increase in Gross Enrolment Rate:% Points of relevant age group between 1980 and 1996:			
Primary	23	24	-
Secondary	16	21	-
Tertiary	2	1	-

Source: Increase in enrolment figures are from World Bank, 1999. All other figures are from UNDP, 1999. - means not available.

25. Life expectancy is 57.3 years, lower than the South Asian average of 62.7 years but substantially higher than the average of 51.7 years for the least-developed countries, most of which belong to Sub-Saharan Africa. (SSA), a region in which many countries in recent years have experienced a significant *absolute* reduction in life expectancy largely due to the AIDS epidemic.⁴ Adult literacy rate in Nepal, 38.1 per cent, is lower than the adult literacy rates in both South Asia (52.2 per cent) and the least-developed countries (50.7 per cent). Nepal however has a higher combined gross enrolment at primary, secondary and tertiary levels (59 per cent) than both South Asia (52 per cent) and the least-developed countries (37 per cent).

26. Women in Nepal have a lower than average level of human development according to all the above indicators: the disadvantage that Nepalese women are subject to is most dramatically illustrated by the fact that of all the countries of the world that the World Bank, 1999 reports on, Nepal and Uganda are the only ones in which women have a lower life expectancy than men.⁵ Adult literacy rate for women is less than half of the adult literacy rate for men. School enrolment rate for women is lower than for men, just over half in the case of secondary schools. "Economic participation" of women in the labour force is much lower than for men. Women workers are disproportionately concentrated in agriculture. Female wage rate is 75 per cent and 87 per cent of male wage rate respectively in urban and rural areas.⁶

27. Environmental degradation, itself partly caused by the desperation of the poor to eke out a living by whatever means are feasible, has become a significant obstacle to growth. Erosion of the top soil is widespread and an impediment to agricultural productivity. Depletion of forests and natural resources has reached serious proportions. In the Kathmandu valley, environmental pollution is a significant threat to healthy human living. Huge hydroelectric potential remains unexploited due to large and indivisible investment costs that Nepal is unable to finance on its own. Despite the great shortage of power in neighbouring India and Bangladesh, there has not been an agreement for regional and/or multilateral exploitation of these resources. The country therefore continues to depend on fuel wood for the supply of 90 per cent of its energy need with an adverse environmental consequence. Improper disposal of non-biodegradable waste, due largely to unregulated expansion of industries and tourism, has further aggravated environmental pollution.

28. Nepal's long-term progress in human development and its components has been mixed. The human development index (HDI) itself increased from 0.289 in 1975 to 0.463 in 1997, an annual rate of increase of nearly 2.2 per cent. This is higher than the increase in HDI in Bangladesh and Pakistan (respectively 1.5 per cent and 1.7 per cent per year).⁷ In the two decades between 1975 and 1995, per capita GDP, at constant 1987 US\$, increased at 1.6 per cent per year in Nepal, a significantly lower rate of growth than what South Asia and the least-developed countries achieved (Table 1).

29. This means that Nepal's performance in non-income components of human development has been better than the performance of South Asia and the least-developed countries in the same areas. Between 1970 and 1997 Nepal achieved a 15.2 years' increase in life expectancy and a 52 per cent reduction in the infant mortality rate. These are higher than what South Asia and the least-developed countries achieved over the same period. Nepal's *progress* is comparable to that of South Asia in primary enrolment but inferior in secondary enrolment. Nepal's higher rate of *progress* in tertiary enrolment is a reflection of its low initial level.

30. It is very hard to compare progress in gender deprivation over time. It however appears that Nepal's progress in this regard was slower than in the other South Asian countries. Two decades before, Bangladesh, India and Pakistan had a lower life expectancy for women than for men as did Nepal. By 1997 Nepal remained the only South Asian country with a lower life expectancy for women than for men. The proportionate difference between men and women in literacy and school enrolment has declined rather slowly.

31. It is harder still to compare relative performance in environmental protection. Crude and partial indicators suggest that Nepal experienced a higher rate of deforestation (1.1 per cent per year during 1980-95) than did South Asia as a whole (0.2 per cent).⁸ While hard evidence can not be documented, it is widely believed that erosion of topsoil, pollution of urban environment and improper disposal of non-biodegradable waste have been unabated over time.

32. Evidence on trend in poverty is difficult to interpret because available estimates at different time periods were made by different agencies. It is uncertain to what extent their methods are comparable. A recent World Bank report (World Bank, 1998), however, arrives at the following conclusions about changes in the incidence of poverty between years for which detailed household surveys are available after a careful perusal of all available evidence:⁹

(i) There is no evidence of a decline in poverty for Nepal as a whole between 1976/77 and 1995/96;

(ii) There is also no evidence of a decline in poverty for Nepal as a whole between 1984/85 and 1995/96 while there is at least some weak evidence to suggest that poverty in Nepal increased during this period;

(iii) There is evidence to inspire greater confidence in the proposition that poverty in rural Nepal increased over both the time periods;

(iv) There is some evidence to suggest that urban poverty declined, though at an undramatic rate; and, finally,

(v) While rural poverty elsewhere has continued to increase, during the 1990s there may have been a slight decline in poverty in rural areas surrounding Kathmandu valley and in Terai.¹⁰

33. The adverse poverty trend in rural Nepal is primarily due to the slow growth of agriculture. During the 1980s value added in agriculture increased at 4 per cent per year, significantly faster than rural population which probably grew at something like 2.5 per cent per year. This implies a significant increase in per capita agricultural *output* for which to be translated into an equivalent increase in per capita agricultural *income* agriculture's terms of trade must have remained unchanged. During the 1980s the deflator for agricultural value added increased at 9.79 per cent per year while the GDP deflator increased at 10.81 per cent per year. The gap between the deflators for agricultural and *non-agricultural* GDP was obviously much higher. This suggests that the terms of trade for agriculture declined significantly, leading to a far slower increase in agricultural *income* than agricultural *output*. During the 1990s the growth in agricultural output itself fell sharply, to only 2.2 per cent per year between 1990 and 1997.

34. In urban Nepal income growth was more rapid. But the full poverty-reduction potential of income growth was not realized due to a rise in inequality. Once again the evidence is somewhat blurred by the lack of comparability of the data on the basis of which Gini ratios are estimated for 1985 and 1995. *Per capita*-income-ranked Gini ratio increased sharply for urban areas and quite substantially for rural areas between 1985 and 1996.¹¹

35. To summarize: relative to that in other developing countries, the level of human development is very low in Nepal, though not as low as its per capita GNP. Nepal also has very low levels of attainment in individual components of human development - income, life expectancy, literacy and the status of women. Enrolment in primary education is an exception to this pattern. During the last two decades or so, Nepal's progress in human development, in comparison with the progress in the same in other developing countries, has been very mixed. It has experienced a very slow growth in per capita income. Advances in life expectancy and certain aspects of education have been better. Income distribution appears to have become more unequal and the incidence of absolute poverty has increased in rural areas and in Nepal as a whole. Progress in reducing the gender imbalance in development has been slow and the deterioration in environment has not been arrested.

III. INTEGRATION WITH THE GLOBAL ECONOMY

De Facto Integration with India

36. Nepal's integration with the global economy, and the consequent patterns of trade and production, are very strongly influenced by its landlocked location, more than 900 kilometers away from the nearest port, separated by an extremely undeveloped transport and infrastructure of the neighbouring countries. Switzerland and Austria are outstanding examples of landlocked countries with some of the highest levels of development in contemporary world. But the asymmetry between Nepal on the one hand and Switzerland and Austria on the other is that between Nepal and the nearest ports of access lie India and Bangladesh - countries that are very poor themselves with extremely undeveloped infrastructure - while across the much shorter distance between Switzerland and Austria and their nearest ports lie countries with the most highly developed systems of transport and infrastructure in the world. Thus, compared to these European landlocked countries, Nepal is faced with an extremely high cost of transport and transit between itself and the ports. Even without any further problem with its location, Nepal would therefore be at a serious disadvantage in terms of deriving the benefits of integration with the global economy: its trade/GDP ratio could be higher than it actually is if its location had not imposed this high cost of transport and transit to the ports from which it can have access to markets other than those of its poor neighbours.

37. Three sides of Nepal's border is surrounded by India while the northern border is shared with Tibet, itself a remote and less developed province of China. The straight-line distance to the nearest Chinese port is more than 5,000 kilometers. For access to ports in Bangladesh, it is necessary to transit through a strip of Indian territory. The high cost of transit to ports for access to the rest of the world and India's control over the terms of transit put Nepal in a situation of *de facto* free trade with India ever since the first agreement on trade and transit in 1923 which assured the British free access to Nepal's market which is alleged to have led to a collapse of Nepal's cottage industries and retarded its industrialization.¹² Subsequent treaties with independent India - starting with the first one in 1950 through the most recent one in 1996 - have by and large ensured that Nepalese trade regime conforms to India's trade and tariff policies with India's readiness to use its control over transit rights to make Nepal conform to this basic condition. Perhaps it should be emphasized that more than the formal provisions of these treaties, the open border with India and the high cost of access to the markets of the rest of the world were the decisive factors in putting Nepal in a situation of *de facto* free trade with India.¹³ Even without the provisions of formal trade agreements, any attempt to create trading relations with the rest of the world through *standard instruments of trade policy* - tariffs and export subsidies - would be thwarted by unofficial and unrecorded movement of goods and services across the open border.

38. The consequence of the above circumstances was the emergence of India as the overwhelmingly dominant trade partner of Nepal. In 1974/75 India accounted for 84 per cent of Nepal's exports and 81 per cent of Nepal's imports. This "free trade" with India was of dubious benefit to Nepal because: (a) India's economy was characterized by widespread and arbitrary protection, creating a great deal of inefficiency in its structure of production and trade; and (b) Nepal could not have recourse to traditional methods of protecting its legitimate infant industries.

39. One must address the question why India's share of Nepal's external trade declined sharply from the peak of the mid 1970s and whether it indicated a change in the above outcome. By 1978/79 India's share had fallen to 50 per cent of Nepal's exports and 55 per cent of its imports. The trend continued until 1992/93 when these shares fell to a remarkably low 15 per cent and 33 per cent.

40. The rise in the share of the rest of the world in Nepal's exports was a result of Nepal's use of incentives to promote them. It started in the 1960s with the Export Exchange Entitlement which allowed the exporters to retain a part of their earnings of convertible currency for import of goods which could be sold at a high premium. In 1978 it was replaced by a dual exchange rate allowing a substantially more favourable rate for convertible currency exports. Cash subsidies for exports to the rest of the world were also used.

41. The reduction in India's share of imports was due to a number of reasons. India was Nepal's major external donor until the 1970s when the multilateral and other bilateral donors began to accelerate their assistance to Nepal as India started to reduce its assistance. This had an important effect on the source of imports which were often tied to the source of funds. Secondly, supply difficulties led India to impose quantitative restriction on the export of such goods as cement; iron and steel products; coal; petroleum products; and sugar. Thirdly, the decline in India's share of recorded imports was far less than of exports, the actual decline perhaps merely reflecting an accommodation for imports tied to external assistance from other sources. Even so, it is certain that unrecorded imports from India were substantial and particularly concentrated in products in which Nepal might hope to promote domestic industries.

42. The decline in India's share of Nepal's trade does not constitute an evidence that Nepal's trade and industrialization policies can overcome the consequences of its *de facto* integration with the Indian economy. There is evidence that, beyond a point, incentives for export to (and disincentives for imports from) the rest of the world simply induces Indian goods to enter Nepal to be re-exported abroad (to replace imports from abroad). Soon after the institution of Export Exchange Entitlements, Nepal's recorded exports of jute and jute goods to the rest of the world in the late 1960s exceeded total domestic production, indicating an influx of those goods from India. Thus the reduction in India's share of recorded imports does not reflect an ability on Nepal's part to protect its infants from competition from more mature industries producing the same goods in India.

Liberalization of Controls and Integration with the Global Economy

43. It should be intuitively clear that Nepal had nothing to lose by extending its *de facto* integration with distorted and protected India to an integration with the global economy. While such a transition would by itself not enhance Nepal's ability to promote worthwhile infants, it would at least protect it from the transmission of the consequences of the distorted structure of production that India's economy embodied. The paradox however is that Nepal's ability to integrate with the global economy itself is limited by India's integration with the latter. Nepal took important steps for the liberalization of its economic policies in 1986 under the Structural Adjustment Programme (SAP) by: rationalizing the tariff structure; reducing fiscal deficits; eliminating controls on the prices of consumer goods and interest rates; and privatizing numerous state-owned enterprises. But the opportunity for dramatic reforms for integration with the global economy came in the early 1990s when India started opening up to the global economy in a big way.

44. The reforms that Nepal initiated in the early 1990s to facilitate integration with the global economy may be summarized as follows:¹⁴

(a) Quantitative restrictions on imports were completely eliminated in a number of quick steps implemented between February 1992 and July 1993.

(b) The structure of tariffs was rationalized by a general reduction in rates and a reduction in the number of rate slabs with the majority of imports being subject to customs tariff rates ranging between 10 per cent and 20 per cent. The trade-weighted average of nominal tariff rates declined from about 80 per cent in the early 1980s to about 31 per cent in 1993/94. By 1997 it had fallen to 18.6 per cent.¹⁵ The average effective protection rate declined dramatically after the late 1980s.

(c) The past bias of the import substituting industrialization (ISI) regime against exports had already been reduced substantially in the early 1980s. The ratio of effective exchange rate for exports to effective exchange rate for imports had increased from 0.74 in 1980 to 0.92 in 1982. There was no further improvement in relative incentive for exports thereafter. Some exports are still subject to taxation and most exports pay small service charges which have been further reduced in the early 1990s. Available estimates of effective exchange rates however suggest that Nepal's exports are still subject to some discrimination relative to import substitutes.

(d) Following similar action by India, Nepal introduced partial current account convertibility of its currency in March 1992 and full current account convertibility in February 1993. While nominal exchange rates have been based on the pegging of the Nepalese Rupee with the

Indian Rupee, the real exchange rates vis-a-vis the Indian Rupee and the US\$ have diverged due to differences in trade incentives depending on origin/destination (Table 2).

It is notable that in the period of globalization Nepal's currency has substantially depreciated against the US\$ in *real terms* but *appreciated* against the Indian Rupee a good deal. It is also notable that the *real* depreciation of Nepal's currency vis-a-vis the US\$ has been far less aggressive than the *real* depreciation of the Indian currency against the US\$ over the same period. This indicates a relative loss of Nepal's competitiveness vis-a-vis India in the international market.

Table 2
Index of Real Exchange Rate (RER) (1985 = 100)

	Nepalese Rupee Against		Indian Rupee Against US\$
	Indian Rupee	US\$	
1981	91.7	135.5	-
1985	100.0	100.0	100.0
1990	106.5	89.9	82.4
1995	115.3	74.1	62.3
1997	118.3	72.2	60.4

Source: Khatiwada, 1999

(e) Nepal also took a number of steps to attract foreign direct investment (FDI) and other forms of private foreign investment. The enactment of the Foreign Investment and Technology Transfer Act of 1992 formalized these measures. Foreign investors are allowed to own up to 25 per cent of the stock of the listed companies and 100 per cent of foreign ownership is permitted for FDI in small, medium and (non-listed) large-scale industries with the exception of some industries of strategic, public health and environmental importance. Repatriation of return on investment in convertible currencies is guaranteed. These industries are also entitled to all the facilities and incentives, e.g., tax incentives, provided to the domestic investors.

45. Together these reforms represent a fundamental departure from the past ISI strategy and a major attempt to open up the economy. Indeed reforms have often gone substantially further than corresponding reforms in India. Thus, for example, the weighted mean tariff rate in 1997 was 27.7 per cent for India as compared to 18.6 per cent for Nepal.¹⁶

46. Integration with the global economy coincided with the liberalization of economic policies across the board which did not always directly affect the process of integration.¹⁷ These policies partly preceded the reform of the trade regime as many of them were implemented under the SAP in the mid 1980s. Agricultural inputs and outputs were allowed to be priced more according to market forces as subsidies on fertilizer and other inputs began to be phased out. Price and distribution controls were curtailed. Interest rates were deregulated and Banks were gradually freed from administrative control over their operations. Attempts were made to reduce the regulation of the labour market. There was increased emphasis on macroeconomic stability: controlling budgetary and external deficits and price inflation.

IV. EFFECTS OF INTEGRATION WITH THE GLOBAL ECONOMY

47. Reforms for integration with the global economy are supposed to benefit a country in a number of ways. First, they allow a country to restructure production and trade on the basis of comparative advantage which increases the ratio of trade to GDP and creates a structure of exports that is more consistent with resource endowments. Secondly, they promote higher growth due to a greater efficiency of resource allocation; a greater access to economies of scale when production for the limited domestic market under ISI is replaced by production for both domestic and export markets; and a larger inflow of foreign investment and technology. Thirdly, they should improve the distribution of income which, together with higher growth, should help reduce poverty. This is because a restructuring of production according to comparative advantage increases demand for the abundant factor, labour, leading to higher employment and real wages. This is the most viable and effective method of improving the distribution of income and reducing poverty. It is useful to analyze the outcome of reforms in Nepal under each of these headings. This can be done by comparing Nepal's performance during the 1990s with its performance during the previous time period in each of the above areas. Intensive reforms for integration with the global economy were implemented during the first three years of the 1990s. By the mid 1990s their results should have started becoming available.

48. In this paper the period leading to 1991 is referred to as the pre-globalization period while the period since 1991 is referred to as the post-globalization period. While some reforms had been initiated before 1991, it is unlikely that the results of the more dramatic reforms materialized before the mid 1990s and, in any case, the 1990s, especially the years after the implementation of the reform of the trade regime, should reflect the consequences of integration with the global economy more fully than any prior time period. While the time that has elapsed since the implementation of these reforms is rather short for a final verdict on their outcome, it has been long enough to give some idea of how these reforms are likely to affect the economy in the long run and, especially, what additional steps might be the necessary to improve their effectiveness.

Volume and Pattern of Trade

49. Table 3 shows changes in some of the trade-related variable. Some features of the broad pattern that emerges from these and other facts may be summarized as follows.

(a) For a small country, Nepal's merchandise-trade/GDP ratio is low. World Bank 1999 shows that for 1997 Nepal's merchandise trade is 4.1 per cent of GDP at PPP\$ as compared to 8.4 per cent for all low-income countries and its merchandise trade is 30.5 per cent of "goods GDP" as compared to 52.0 per cent for all low-income countries. This is largely a reflection of landlocked Nepal's high cost of transit to the ports for access to the world market to which attention has been drawn above.

Table 3
Export/GDP Ratio, Origin and Destination of Trade; and Export/Import Ratio (Per Cent)

Fiscal Year Ending in July	Export/GDP Ratio		India's Share of Merchandise Trade		Export /Import Ratio
	Goods	Goods & Services	Export	Import	Goods & Services
1981	6.3	13.8	61.7	49.2	66
1986	5.8	12.3	40.3	42.5	58
1987	5.0	12.5	43.5	39.1	58
1988	5.7	12.1	38.1	33.1	53
1989	5.0	11.7	24.7	26.1	52
1990	5.3	11.1	11.7	25.5	50
1991	6.5	12.5	21.0	31.5	51
1992	9.7	16.8	10.6	35.2	61
1993	9.4	19.1	9.4	32.0	65
1994	10.3	25.4	12.5	33.0	76
1995	8.6	25.9	17.7	30.8	70
1996	8.5	23.7	18.5	32.8	62
1997	8.6	28.1	23.1	26.6	68

Source: Khatiwada, 1999. All ratios are based on current values of variables in Nepalese currency.

(b) There was a distinct rise in the ratio of exports to GDP in the post-globalization period. The beginning of the upward shift in the export/GDP ratio slightly *preceded* the major reforms for integration with the global economy. The rise in the export/GDP ratio was far higher for services than for goods. The rise in merchandise-exports/GDP ratio was modest and not sustained after the implementation of the major reforms. Merchandise-export/GDP ratio in the mid and late 1990s is however higher than the ratio in the 1980s.

(c) The growth in services export is substantially a reflection of increased remittances made by the Nepalese workers employed abroad. Miscellaneous services exports reported in Nepal's balance of payments include the remittances made in the form of gold imports paid for by the Nepalese workers abroad while cash remittances are recorded as private transfers.

This means that much of the "export of services" did not consist of services produced in the domestic economy, a phenomenon that explains the low backward linkage of "services exports" to domestic production.

(d) Over time Nepal's merchandise exports have become less diversified with an unhealthy concentration in just two goods, carpets and garments. They accounted for 79 per cent of all merchandise exports in 1994. A fall in their share, to about two-thirds by 1997, is more a reflection of an absolute fall in their exports rather than an increased diversification due to an expansion of the export of other goods. This was brought about by the concern in the importing OECD countries that Nepal's carpet exports exploited child labour and used an environment-hostile dye. These problems have since been addressed by Nepal though the value of these exports has not reached the previous peak. The fall in export of garments in recent years is probably due to supply bottlenecks. These problems indicate the vulnerability of Nepal's undiversified exports of goods especially in the context of the impending abolition of quotas for garments exports.

(e) Thanks to the rapid growth of foreign exchange earnings, the ratio of imports financed by "export earnings" has increased in the post-globalization period. This ratio peaked in 1994 at 76 per cent and fell thereafter.

(f) Measures aimed at attracting FDI have achieved very limited success. Nepal traditionally received very little FDI, so it is not surprising that the volume of FDI has gone up. The total value of FDI inflow still remains modest and has fallen from the peak reached in 1997.¹⁸

(g) An interesting feature of Nepal's integration with the global economy is that the proportion of its exports destined for the Indian market has risen substantially from the very low levels to which it had fallen in the late 1980s and the early 1990s. This is largely due to the much improved access of Nepalese exports to the Indian market provided by the 1996 Trade Treaty. This may also partly be due to the fact that the opening up of both the economies has reduced the gap between the incentive for exports paid for in hard currencies and the incentive for exports paid for in Indian Rupees. The access of recorded exports to the Indian market however continues to be subject to difficulties that might be described as non-tariff barriers as is demonstrated by the case of Nepal's Ghee exports to India.¹⁹ India's share of Nepal's recorded imports does not appear to have been affected much by the globalization process. Needless to repeat, there is a good deal of uncertainty about the proportion of border trade with India that is actually recorded.

(h) Nepal has been a member of the South Asian Association for Regional Cooperation (SAARC) from its inception. Trade with SAARC countries other than India however remains very small, less than five per cent of exports and just about one per cent of imports. This is because SAARC has led to virtually no intra-regional economic integration. Access to and from SAARC countries other than India remains subject to the high cost of transport to which repeated references have been made. India has granted transit rights to Bangladesh which lies across a narrow strip of Indian territory. This by itself has not been sufficient to create vigorous trade between these two countries, partly due to the high transport cost reflecting undeveloped infrastructure, and partly due to supply inelasticities in both countries.

(i) As noted in the preceding section, Nepalese Rupee (NR) has appreciated against the Indian Rupee (IR) which must have had a negative impact on Nepal's international competitiveness.²⁰ The relative values of the NR and the IR are, however, determined by market forces. The rise in the value of the NR relative to the IR must be explained by the relatively more comfortable supply/demand balance for foreign exchange in Nepal as compared to that in India. There has been a rise in the ratio of export earnings to import payments to which must be added the high inflow of foreign capital, mostly in the form of official development assistance. To end the appreciation of the NR, relative to the IR, while their values continue to be determined by market forces, Nepal must bring about an upward shift in imports by an acceleration of economic growth. This point is elaborated later.

Growth

50. It is very hard to conclusively establish the effect of reforms on growth. Reforms for integration with the global economy were intensified halfway during the period 1990/91 - 1994/95 shown in Table 4.²¹ It is therefore arguable that a part of the higher growth rate during this period was due to the reforms. There is little evidence that these intensified reforms had a sustained positive impact on growth which declined sharply since 1995/96, shortly after the reforms were concluded. During this period, the decline in the growth rate was particularly sharp for industries and services.

Table 4
Annual Growth Rates (Per Cent)

	1985/86-1989/90	1990/91-1994/95	1995/96-1997/98
GDP	4.8	5.02	3.98
Agriculture	4.10	1.55	3.22
Industry	6.07	9.42	4.02
(Manufacturing)	(5.19)	(14.03)	(5.72)
Services	5.32	7.44	4.78
(Trade, Restaurants, Hotels)	(4.37)	(7.54)	(3.94)
(Finance & Real Estate)	(5.21)	(6.36)	(5.91)
(Other Services)	(6.06)	(8.01)	(4.69)

Source: HMG/Ministry of Finance, *Economic Survey*, various issues.

51. It is not particularly surprising that reforms did not result in higher growth for industries. The benefit of globalization for growth derives from the exploitation of the benefits of trade. As discussed above, the growth in merchandise exports was not robust. The question is whether the reforms themselves contributed to the slowdown of the economy. This is a question that one can not hope to deal with in any definitive manner. There appears to be a widely-held, though hitherto undocumented, belief on the part of a cross section of the business community that the policy of opening up to the world economy has been responsible for the closure of many enterprises that had developed in the past. This view is consistent with the sharp decline in the rate of growth of manufacturing industries since the middle of the 1990s.

52. Industries in Nepal suffer from a general condition of infancy due to the undeveloped infrastructure, lack of skills, the high cost of imported inputs and a very high transactions cost arising out of the backward institutions and inadequate public administration. As discussed earlier in the report, industries which competed with established Indian industries had little compensation for their infancy due to the open border with India. For the limited number of nascent industries that did not have, or were able to withstand, competition from India, the protection from competition from the rest of the world was a major source of profit. The system of protection was of course distorted and inefficient; but it was very profitable for the industries which were protected. With the dramatic decline in the effective protection rate, the profitability of many of these industries was undoubtedly adversely affected. It is true that the past system of arbitrary and distorted protection needed to be discarded in the interest of greater efficiency. But it was essential to replace them, at least partly, by

a more sensible alternative system of compensation to offset the factors causing inflexibility on the part of the industries. By failing to create an alternative system of promotion of industries, the reforms for liberalization and integration may have contributed to the decline of industrial growth that Nepal has experienced in recent years.

53. As noted above, the rapid growth in "services exports" did not have a powerful linkage with domestic production of services because these "exports" largely represented remittances by the Nepalese residents abroad. It is therefore not surprising that the growth of services output actually declined.

54. Nepal's agriculture achieved a decent rate of growth during the 1980s after an absolute decline during the preceding half decade. In the first half of the 1990s agricultural growth was sharply lower. Since 1995/96 agriculture has recovered a little, but the rate of growth in recent years is still substantially lower than the growth rate during the 1980s. Between 1990/91 and 1997/98 the use of total fertilizer has declined by 25 per cent.²² Much of it may have been due to the rise in relative fertilizer prices which was in turn a result of the liberalization policies and attendant measures. While the rise in fertilizer prices to their international level is in principle desirable, its adverse effect on the profitability of agricultural production should have been offset by compensating policies, e.g., improved infrastructure, better access to credit, more public funds for the development and dissemination of improved seeds and additional transitional measures to cushion the peasants from the effect of the rising input prices until increased productivity enabled them to absorb the higher cost. The opening up of fertilizer import and trade to private sector should have helped improve the distribution of fertilizer. It has, however, been alleged that competition among private traders is not sufficiently well developed to make the transition to private trading as beneficial to the users of fertilizer as it otherwise would be. Indeed there is widespread allegation that privatization has led to a reduction of the quality of fertilizer distributed, indicating insufficient competition among traders.

55. The decline in fertilizer use is not the only retardation that Nepal's agriculture experienced in the 1990s. Between 1990/91 and 1997/98 the total use of improved seeds also declined albeit at a smaller rate compared to the decline of fertilizer use. This indicates that Nepal's long lag in catching up with the green revolution that swept Asia three decades ago has been accentuated in the age of globalization.

56. Nepal's investment rate increased in the post-globalization period. This is in sharp contrast to the collapse of the growth rate of the economy. Given the much greater uncertainty of the expenditure account of the GDP, on which the estimates of saving and investment rates are based, one needs to look more carefully at the investment estimates and their composition.²³ It is altogether possible that much of the modest increase in the estimated rate of investment is a reflection of an

upward shift in the relative domestic price of investment goods, which are largely imported or based on imported inputs, as a result of the change in the trade regime. It is noteworthy that the rise in the rate of investment has not been accompanied by a rise in the rate of saving. The saving rate in recent years is, on the average, no higher than the peak reached in the mid 1980s.

Table 5
Investment and Savings (Per cent of GDP)
(Fiscal Year Ending in July)

Year	Investment	Saving	Year	Investment	Saving
1981	17.6	10.9	1991	20.8	9.6
			1992	21.2	10.8
1985	21.9	13.4	1993	23.1	13.5
1986	19.0	13.4	1994	22.4	14.7
1987	20.2	11.5	1995	25.2	14.7
1988	19.8	9.9			
1989	21.7	11.4	1996	27.3	13.8
1990	18.4	7.9	1997	25.1	12.8

Note: These estimates are based on investment, savings and GDP at current prices shown in Khatiwada, 1999.

Income Distribution and Poverty

57. It is particularly difficult to determine the effect of Nepal's reforms for integration with the global economy on the distribution of income and the incidence of poverty. This involves, first, a determination of the *actual* changes in income distribution and poverty between the pre-globalization period and the post-globalization period and, second, finding a causal link between these changes and the process of globalization. Given the great uncertainty about the data on the principal variables that are involved, this is an extremely difficult, if not altogether an impossible task.

58. As shown in section II above, the distribution of income in both rural and urban Nepal is likely to have become substantially more unequal between 1984/85 and 1995/96 - the two most recent years for which household surveys are available - although it is hard to be confident about the magnitude of change in view of the differences in the methods of the surveys for the two years. Determining the change in the distribution of income in the 1990s is harder still because of the absence of a household survey at or around the turn of the decade.

59. If, however, the per capita distributions of 1985 NRB Survey and the 1996 NLSS Survey are comparable, then it is unlikely that the sharp rise in the urban inequality indicated by them - the Gini ratio rising from 0.26 to 0.43 - could take place entirely within the second half of the 1980s. It is far more likely that there was a significant rise in urban inequality during the 1990s.

60. One could also argue, with less confidence, that the rise in the rural Gini ratio from 0.23 to 0.31 over the same period indicates the possibility of some rise in inequality during the 1990s. During this period, slow growth notwithstanding, agriculture had to absorb a good deal of labour with a probable negative impact on labour productivity and real wages/earnings.²⁴

61. The rise in per capita rural income during the 1990s has so far been very slight, if at all positive.²⁵ With such weak growth, the incidence of rural poverty is likely to have increased even if there was only a mild rise in the inequality of rural income distribution, a possibility that invites little disagreement among analysts of Nepal's poverty scene. Even so, it has been argued that there might have been some slight reduction in rural poverty in Kathmandu valley and the rural Terai region while rural poverty elsewhere increased between 1991/2 and 1995/96.²⁶

62. The rise in per capita urban income during the 1990s has been quite substantial, though much lower in the period since 1995/96 than in the first half of the 1990s. The rise in inequality has also been quite high although it may not have completely offset the poverty-alleviating effect of the rise in per capita income. There is however little reliable information about the pattern of regional disparity in urban growth although it is well documented that Kathmandu experienced a much faster growth than the rest of urban Nepal. It is possible that the reduction of urban poverty was mainly concentrated in Kathmandu and a few rapidly-growing urban centres while many other urban areas experienced little reduction in poverty.

63. It is one thing to argue that the distribution of urban income and the incidence of urban poverty changed in a particular direction; it is quite another to find a necessary link between these changes and the process of integration with the global economy. For the latter it is necessary to identify the nature of the influence that globalization had in Nepal on the principal mechanisms through which it is supposed to influence distribution, namely: the degree of labour intensity of growth; the adjustment in the structure of domestic prices and their consequences on the welfare of the poor; and the change in the composition and location of public expenditure, among other things.

64. The evidence on employment is murky and often contradictory. Principal findings from available sources may be summarized as follows:

(a) Estimates of factor intensity in manufacturing, available for 1986/87 and 1993/94, show a 51 per cent rise in capital/labour ratio (evidence quoted in Karmacharya, 2000).

(b) A comparison of the findings of the Manufacturing Surveys of 1991/92 and 1996/97 shows that employment in the organized manufacturing industries (enterprises employing 10 or more workers) declined by 23 per cent (reported in Bajracharya, 2000).

(c) Estimates by the Central Bureau of Statistics (CBS) report that employment in both agriculture and non-agricultural (but not manufacturing) sectors increased faster during 1991-96 period than in the decade of 1981-91 and that the rate of growth in employment during the post-globalization period was far greater than the rate of growth in output in non-agricultural sector as a whole, implying a sharp decline in labour productivity (reported in Karmacharya, 2000).

(d) Estimates based on CBS= Multipurpose Household Budget Survey for 1984/85 and the Living Standard Measurement Survey (LSMS) for 1995 show that between those dates both the rates of unemployment and underemployment (percentage of employed workers working less than 40 hours per week) increased in both rural and urban Nepal²⁷.

(e) Nepal Rashtira Bank estimates (quoted in Karmacharya, 2000) show a significant increase in real wages of industrial workers between 1990 and 1996 and a rather sharp fall in the following year.

65. It is important to resolve the apparent inconsistency among these evidences in order to arrive at an understanding of the effect that integration with the global economy may have had so far on the growth of employment. The resolution of the inconsistency among different pieces of evidence, however, requires an amount of information far beyond what is currently available in Nepal. All that one can do is to arrive at some plausible conclusions concerning the employment scene and then suggest *plausible*, but by no means conclusive, explanations to reconcile the above evidence with them.

66. The conclusions that are most plausible about the trend in employment during the period of globalization are as follows. There is a widespread perception of growing urban unemployment in the post-globalization period which is also borne out by evidences (b) and (d) above. This is also consistent with the findings that the growth rate of urban industries declined and the inequality of urban income distribution increased. The apparent inconsistency between this conclusion and evidence (c) may be explained by the fact that employment in these cases is measured from labour

force type of surveys which go by headcount according to principal occupation of the member of the labour force and not the actual measurement of labour use, e.g, person days of employment. This problem is compounded by the fact that the surveys from which labour force is thus measured were in this case designed by different agencies using very different concepts.²⁸ It is also possible that the loss of employment in organized urban industries coexisted with the growth of rudimentary Aemployment≡ of residual category which resulted in a high rate of growth of observed Aheadcount≡ of employment. The rise in real wages in industries between 1991 and 1996 could be reconciled with the suggested trend in employment if these wages, as it seems likely, relate to the organized sector and if the decline in employment that this sector experienced consisted of the smaller and less efficient enterprises with lower than average wage rate. This is supported by evidence (a) quoted above.

67. For rural Nepal again the estimates shown in Karmacharya, 2000 suggest that growth in employment in the post-globalization period has been higher than what it was in the pre-globalization period although the growth in employment has been slightly lower than the growth of agricultural output. The sharp increase in the implied output elasticity of employment stands in implausible contrast to the hypothesis of increased incidence of absolute poverty in much of rural Nepal. The explanation of this inconsistency almost certainly lies in the inappropriateness of the employment estimates which are based on non-uniform surveys defining employment not in labour use units, but by headcount based on the principal employment category. As shown above, the same surveys reveal a rise in the rates of unemployment and underemployment in rural Nepal over the interval of the latest available surveys. Furthermore, there was a sharp increase in the proportion of women - the lower-paid workers - in agricultural labour force (see below).

68. Admittedly the above represents a set of hypotheses that enable one to make sense of the apparently inconsistent trends in employment-related data during the post-globalization period, not conclusions backed by clearly-documented evidence. Be that as it may, as globalization proceeds, there will be further pressure to reduce employment in public sector industries, which continue to shelter excess employment, and in private industries, which in the past succumbed to the pressure to create excessive employment in the sheltered environment of import-substituting industrialization.

69. Integration with the global economy has altered relative prices in the domestic economy. So far no comprehensive analysis of its impact is available. It has however led to an upward shift in the relative price of imported agricultural inputs, such as fertilizer, and food grains that have a heavy weight in the consumption budget of the workers and the poor in general. These tendencies have been further accentuated by fiscal reforms that have led to a reduction in subsidies on agricultural inputs and consumer goods. The rise in food prices appears to have adversely affected the poor, a very high proportion of whom are net buyers of food. The rise in the price of fertilizers, and of other imported inputs, had at least an indirect adverse effect on the poor by way of reducing the application of these inputs which led to a reduction of peasant output and income. It should perhaps

be made clear that the above should not necessarily be interpreted as a preference for the retention of subsidies for consumers and inputs. These subsidies breed inefficiency and it has been pointed out that often the principal beneficiaries of input subsidies are the larger farmers who are not poor. The point simply is that the poor have been hurt because the removal of these subsidies have not been compensated by a rise in income of the poor consumers (e.g., by the provision of additional employment in public works programmes) or a maintenance of growth and employment in agriculture by compensatory policies to offset the effect of the rise in the price of inputs.

70. Integration with the global economy puts important limitations on the level of public expenditure. Taxes on international trade, often the most convenient and largest source of public revenue for a developing country, declines as a proportion of total revenue. Budgetary deficit must be contained in order to conform to the macroeconomic discipline that greater openness to the world economy requires. Public expenditure in Nepal, as a proportion of GNP, declined from the already low 18.7 per cent during the half decade preceding globalization (1986/87 - 1990/91) to 17.7 per cent during the post-globalization period. The government however not only prevented a fall in the share of the social sectors in public expenditure but actually increased it substantially, from an average of 21.5 per cent in the five years preceding globalization to an average of 27.4 per cent in the post-globalization period. Expenditure on education, as a proportion of public expenditure, increased substantially in the 1990s. Increase in expenditure on health during the 1990s is more ambiguous because in 1996/97, as a proportion of total expenditure, health expenditure was higher than in the early 1990s but lower than the previous peak reached in the late 1970s. Similarly the share of expenditure on the provision of drinking water remained lower than the peak in the early 1990s.

Women

71. Between 1991 and 1996 important changes took place in the pattern of employment for women: (a) Economic activity rate for women shot up from 46 per cent to 66 per cent; (b) Women workers as a proportion of all workers increased from 40 per cent to 52 per cent; (c) Women as a proportion of agricultural workers increased from 45 per cent to 64 per cent; (d) In the non-agricultural sector as a whole women, as a proportion of all workers, increased sharply, from 20 per cent to 28 per cent; (e) *Manufacturing industries* are the only sector in which women, as a proportion of employed workers, fell, from 23 per cent to 21 per cent.²⁹

72. The picture that emerges is that men were leaving agriculture in increasing numbers and were replaced by women who were also increasingly thrown into economic work in non-agricultural activities. They were however losing their share of employment in the more lucrative manufacturing employment. Nepal's garment export industry is far less intensive in the use of female labour than this industry is elsewhere in Asia, a characteristic that derives from the predominance of male migrant labour in the enterprises that are backed by capital and entrepreneurship from neighbouring

India. In carpets, the other major export industry, women were better represented; but, as discussed above, this industry has faced an absolute reduction in output and exports since the mid 1990s. The concentration of women in agriculture, which has been growing at a very slow rate, meant an exacerbation of the disadvantage that women workers traditionally faced in this sector.

Environment

73. It is hard to argue that integration with the global economy has so far had any major direct impact on the environment. As far as the admittedly rudimentary evidence suggests, deforestation and land degradation have continued in the post-globalization period. It is likely that agricultural stagnation and the reduction in the use of modern inputs have led to an increased incidence of agricultural practices that cause land erosion. Concentration of industries in the Kathmandu valley has led to over exploitation of groundwater and a large drop in the groundwater level. All these changes would probably have taken place without an integration with the global economy unless an active strategy of conservation were in place. It has been argued that globalization has provided some environmental benefits. An example of this is the higher price of fertilizer, chemicals and irrigation water. It has been claimed that their lower price in the past discouraged farmers from practicing plant nutrition management systems and encouraged the use of chemicals in ways that are detrimental to land productivity in the long run (IUCN Nepal, 1999). If this is the case, then the environmental benefit has been purchased at a significant cost in terms of agricultural productivity which suffered as a consequence.

Summary

74. Nepal's extensive reform for integration with the global economy has so far brought about a significant increase in exports. A good part of increased export earnings have consisted of "services exports" which actually represent remittances made by the Nepalese workers from abroad. This kind of composition of exports has meant a limited linkage for domestic production. Merchandise exports have not experienced a robust growth; there has been an unhealthy concentration of merchandise exports in two major goods, each of which faces an uncertain prospect for future growth.

75. That an extensive reform of the trade regime and related aspects of the system of incentives has failed to bring about a commensurate change in the volume and structure of trade is explained mainly by an excessively high cost of access to the markets beyond the immediate neighbours; the difficulty of protecting worthwhile infants, given the open border with India; and the absence of complementary measures to promote supply elasticity.

76. Weak trade response led to a weak impulse for the growth and restructuring of domestic production. The abolition of the protection vis-a-vis the non-Indian market exacerbated the problem of competitiveness in the absence of offsetting policies for the promotion of "infant industries". This was reflected in the decline in the rate of growth of industrial production. Reversing agricultural stagnation became harder due to the rise in the cost of modern inputs that was facilitated by the integration with the global economy. There was a limited rise in the rate of investment which was not reflected in a corresponding rise in the rate of growth of output. Indeed the rate of growth of the economy declined soon after the implementation of the dramatic reform of the trade regime. There was no increase in the rate of domestic saving. The rise in the rate of investment was not powerful enough to bring about a supply/demand balance for foreign exchange that would prevent an appreciation of the NR relative to the IR. The result was a weakening of Nepal's international competitiveness.

77. The distribution of income became more unequal in the period of globalization. This was partly due to the disequalizing effects of the rise in the prices of food - a consequence of integration with the global economy - which was not offset by compensatory public action. In part the increase in inequality was due to the failure of productive and remunerative employment to rise. Increased inequality and slow growth contributed to an increase in the incidence of rural poverty, with the possible exception of the rural region surrounding the prosperous Kathmandu valley. The poverty-reduction potential of the more significant urban growth was also substantially offset by the rapid rise in urban inequality.

78. The process of globalization has so far failed to reduce the disadvantage that women suffer. Arguably, the overall pattern of development in the post-globalization period has aggravated the disadvantage suffered by women. It has also failed to reverse the process of environmental degradation. Indeed the exacerbation of rural poverty in the period of globalization may have further aggravated the problem of land degradation.

V. POLICIES FOR SUSTAINABLE HUMAN DEVELOPMENT IN THE AGE OF GLOBALIZATION

79. Despite the questionable performance of the Nepalese economy in the age of globalization, Nepal does not have the choice of reversing the process of its integration with the global economy. As this report carefully analyzed in section II, the consequence of reverting to the protectionism of the past will merely put Nepal back in the state of *de facto* integration with India unless Nepal takes the absurd step of closing its border. There is no reason to believe that a *de facto* integration with India would be more beneficial to Nepal than a meaningful integration with the entire global economy.

80. Can Nepal find a way of translating the vast reform programme that it has implemented into a meaningful integration with the global economy that would create strong enough an impulse for growth with sustainable human development? This report takes the view that this task is indeed feasible, but only by a substantial broadening of the reform programme that Nepal has so far implemented and by cooperative action in partnership with its South Asian neighbours.

81. This section of the overview report will discuss the main ingredients of a strategy for an SHD-friendly integration with the global economy. The discussion will be divided into three distinct sets of policy recommendations: (a) policies for the translation of the reforms of the trade and industry regimes into a dynamic growth of trade and inflow of FDI and technology; (b) the design of integration with the global economy as consistently with poverty reduction, gender balance and environmental protection as possible; and (c) additional domestic policies to promote sustainable human development to compensate for the SHD-hostile forces that efficient integration with the global economy may unleash.

A. Translating Reforms for Integration into Dynamic Growth of Trade, FDI and Technology

Overcoming the Disadvantage of Being Landlocked

82. Reform of Nepal's trade and investment regimes needs to be complemented by a reduction of the high cost of transit to the ports from which it can access markets beyond those of its immediate neighbours. Nepal also needs to find a way of accessing the markets of its subcontinental neighbours other than India.

83. This can be addressed only by cooperative action by Nepal, India and Bangladesh. Guaranteeing transit rights by India is only a *necessary* condition for this. By itself guaranteed transit rights will not remove the disadvantage of Nepal's landlocked location. This can only be removed by the creation of a well-developed network of transport, port and administrative infrastructure in Nepal itself and in India and Bangladesh, a task that needs to be approached within the framework of regional cooperation among these countries. To enable Nepal overcome the obstacles to integration with the global economy, the transit of goods to the points of exit in India and Bangladesh must become smooth, efficient and inexpensive.

Regional Cooperation

84. Nepal's cooperation with its regional neighbours is essential for reasons beyond the removal of the disadvantage of its landlocked location. As noted above, its trade with the regional neighbours, other than India, is pitifully small. Growth of trade with these neighbours, through the creation of something like a SAARC Free Trade Area, is the natural route to a full integration with the global economy.

85. The size of Nepal's domestic market is tiny and a serious obstacle to the exploitation of economies of scale. The size of the Nepalese market in terms of purchasing power is smaller than that of a small US city like Riverside of which the author of this overview paper is a resident.³⁰ It would be absurd to think that a multinational corporation would consider locating a plant in Riverside in order to sell its products *only in that city*. Thus Nepal can hope to attract FDI only by providing them with the opportunity of selling in a much larger market than its own. A SAARC Free Trade Area, created by the removal of trade barriers and the development of transport and trade infrastructure, would have a strongly positive incentive on the part of the multinationals to locate investment in these countries. Within such a Free Trade Area, Nepal could acquire competitive advantage, by appropriate domestic policies and implicitly agreed intra-regional specialization, in a select number of industries in which it would attract FDI.

86. The 1996 Trade Treaty with India already provides an opening in this direction. Manufactures of FDI enterprises in Nepal can in principle enter India without hindrance. This however needs to be backed by adequate infrastructure facilities both in Nepal and in India .

87. Unfortunately, success of this approach depends much more on the actions of its neighbours than on Nepal's own actions. While much can be accomplished by cooperation between Nepal and India to enable Nepal to derive the full advantage of its Trade Treaty, the derivation of the benefit of transforming South Asia into a single market is a much bigger task. This presupposes a degree of cooperation among Nepal's subcontinental neighbours which will have to overcome a great deal of enmity and distrust. Although these neighbouring countries themselves would gain at least as much as Nepal would from their cooperation, the latter has so far proved elusive.

88. Cooperation between Nepal and its neighbours could profitably extend beyond trade and investment to the development of infrastructure overcoming large-scale indivisibilities. Nepal has great hydroelectric potential whose development can be justified only if a high proportion of the power output is transmitted to its power-starved neighbours. There is similar scope for cooperation in water resource development and water control projects. An aggressive exploitation of these possibilities for regional integration is the right path to an integration with the economy of the rest of the world.

Investment in Trade Infrastructure

89. Successful regional cooperation will require Nepal to undertake substantial investment in infrastructure facilities to link up with similar facilities created in the neighbouring countries. If such cooperation does not materialize in the near future, Nepal must plan its own action for whatever access it can promote to the markets of the rest of the world on its own. This too will require a good deal of investment in infrastructure, albeit of a different composition. Facilities will need to be created, for example, for the transportation of the kind of exports that would be profitable for air shipment. An example is the high-valued handicrafts in which Nepal has already created a niche for itself. An expansion of the airport facilities and an efficient air cargo service to a few regional centres, e.g., Bangkok and Singapore, could create conditions for a rapid expansion of exports of this kind.

Improving the Supply Elasticity

90. Nepal needs to diversify the range of its exports and expand their output capacity by appropriate investment. As noted earlier in this report, Nepal faces the difficult problem of promoting its worthwhile infant industries in the face of competition, from across its open border, with comparatively developed Indian industries. This must be accomplished by a combination of the supply of skills, inputs, infrastructure and targeted and time-bound support. The task amounts to the *creation* of comparative advantage in specifically targeted goods and services. Nepal can learn how to go about the implementation of such a strategy from successful examples, such as the Republic of Korea, with due allowance for the difference in its locational circumstances. Given its *de facto*

free trading position vis-a-vis India, Nepal might do well by focusing on a more limited range of goods and services than would otherwise be the case. Initial promotion might consist of the provision of an information network to help identify the market; publicly-funded research for product development; and the provision of production and marketing infrastructure. Further support should be tied to actual export performance and consist of easy and inexpensive credit; fiscal incentives including, in rare cases if necessary, time-bound cash subsidies. As far as can be ascertained, there is nothing in the *existing* Uruguay Round provisions that would be an obstacle to these policies even if Nepal were to become a member of the WTO.

91. The government should have regular consultations with business and the financial institutions about the design and working of the policy of promoting infant exports. The objective should be to clearly define the "rules of the game" and create a system of implementation that is driven by incentives rather than administrative decisions. For example, the identification of the industries eligible for promotion should be based on actual market performance and not administrative certification of eligibility which might promote rent seeking. Once again, a lot can be learnt by studying the experience of the Republic of Korea where monthly export policy meetings between the government and the business community were chaired by the President of the Republic.

92. Tourism is a leading export of Nepal with an enormous scope for further development. There is a need for concentrated effort to exploit its possibilities. The development of the sector however presupposes substantial investment in infrastructure and skill development. This is a sector which should also be attractive to FDI because the size of the market is not limited by the size of Nepal's economy. Much of tourist services can be provided by labour-intensive methods, thereby contributing to an egalitarian distribution of income from backward linkage activities. Careful policies can ensure complementarity between tourism development and environmental protection as well. Preservation of environment is conducive to the development of eco-tourism whereas unregulated expansion of tourist facilities can adversely affect the environment.

93. Nepal must try to preserve and further expand its two largest merchandise exports: carpets and garments. It should diversify the destination of carpet exports. This calls for public support for research in product development and market exploration. There is a serious question mark about the future of garment exports if the MFA is terminated, resulting in the abolition of Nepal's quota. Although it is widely assumed that this is an export in which Nepal has comparative advantage, this has never been tested. High "revealed comparative advantage indices" for garments merely reflect Nepal's relatively large export of these goods under the protective umbrella of import quotas in advanced industrial countries as a part of the MFA which is due to be terminated in the near future. It is widely believed that Nepal's garment exports need continued protection, e.g., an extension of the MFA, in order to overcome its infancy and be competitive with similar exports from other

developing countries, especially the ones in South-East Asia. Some SAARC nations have already asked for an extension of the MFA for five years. While Nepal has not asked for an extension of the MFA, it has made it clear that it would not object if it is granted. The problem is that the abolition of the MFA is viewed as a hard-earned victory for the developing countries which, as a group, will gain much if it is discontinued. The idea of continuing the privilege for the least-developed countries like Nepal while abolishing it for the rest of the developing countries is a contradiction in terms; MFA can not be abolished selectively for some developing countries and retained for the others.

94. Nepal, and other least-developed countries in a similar situation, have been seeking a solution in protecting their garment exports by means other than quotas. One of the proposals that they have floated is zero tariff on their exports to advanced industrial markets. The idea is that this would provide preferential treatment vis-a-vis other developing country exporters. There is a very strong possibility that the advanced countries will grant the least developed countries this privilege. What is not altogether clear is whether the tariff on exports from other developing countries will be significant enough for this privilege to amount to a meaningful preferential treatment. It may be necessary for Nepal to supplement this measure by additional time-bound promotional measures.³¹

95. It appears that the potential for the further growth of the export of handicrafts is very considerable. Nepal should exploit this potential. It should also identify other new exports which it might promote. Selective electronic assembly, to be developed in agreement with the multinationals, in a framework of "agreed specialization" within the SAARC, is an example of such new exports. The promotion of these new exports would call for broad-based support including research in product development and assistance in marketing.

96. Nepal should try to revive some of its traditional exports which have greatly declined in importance in recent years. Leading in this category are jute products, leather and agricultural products. An expansion of these exports, especially jute and leather products, presupposes new product development an interesting twist in which is the development of environment-friendly substitutes of non-biodegradable packing material that once pushed jute out of the market.

97. As noted above, exports are still discriminated against import substitutes. Existing export taxes and service fees on exports need careful examination to put an end to any unjustified discrimination against exports.

Exchange Rate

98. This report has argued that Nepal's international competitiveness has been adversely affected in recent years by the appreciation of the NR relative to the IR. The puzzling phenomenon is that, although the NR is formally pegged to the IR, their relative prices have by and large been market determined. How does one interpret the phenomenon of appreciation of the NR and what might be the appropriate course of action to deal with the problem?

99. Relative prices of the currencies are determined by the relative supply-demand balances for foreign exchange in the two countries. The fact that NR has appreciated relative to IR merely reflects the fact that the supply-demand balance for foreign exchange has been becoming relatively more favourable in Nepal than in India. Low demand for foreign exchange in Nepal, given its foreign exchange earnings and the relatively large inflow of foreign capital, principally in the form of official development assistance (ODA), is a reflection, among other things, of low investment. Demand for investment is in turn limited by low international competitiveness. Low international competitiveness is due, among other things, to the appreciation of the exchange rate vis-a-vis the currency of its giant neighbour. Nepal is thus faced with a vicious circle of low international competitiveness causing an appreciation of the NR which in turn is making Nepal internationally uncompetitive. This vicious circle must be broken to enhance Nepal's competitiveness. The most effective way to break it is to create competitiveness for enough worthwhile infants by a system of promotion outlined above. This should increase demand for investment and foreign exchange and bring down the value of NR.

Capital Account

100. Liberalization of the capital account is not a live issue for Nepal. India is unlikely to adopt this policy in the foreseeable future and there is no question of Nepal's adoption of this policy ahead of India. In the wake of the Asian crisis of 1997, the enthusiasm of the multilateral donor agencies for the liberalization of the capital account has greatly waned. Nepal is unlikely to face any pressure to adopt this policy. The benefit that Nepal can derive from the liberalization of the capital account, beyond adopting policies to attract FDI, is very limited because of the extremely limited size of its securities market.

Membership of the World Trade Organization (WTO)

101. Nepal currently has an observer status at the WTO. It has applied for full membership and is waiting to be admitted as one. By itself full membership of WTO will not have a significant effect on Nepal's integration with the global economy. But it will allow Nepal to seek arbitration should its rights be infringed by other members. These rights include unconditional freedom of transit for landlocked countries through the territories of its neighbours and protection from dumping.³² It should however be recognized that the cost of seeking arbitration is very high; it requires a high level of legal expertise and negotiating infrastructure. These are often beyond the means of the developing countries.

102. As it becomes a full member of the WTO, Nepal must retain two important types of freedom of action, namely, the right to provide time-bound support to infant industries and the right to limit the liberalization of capital account. As of now, the WTO rules do not preclude these rights. As a least developed country Nepal can continue to provide wide-ranging support to its domestic industries and exports. It is important for Nepal to join hands with other developing countries to preserve these rights as the next round of WTO negotiations unfold.

B. Dealing with the Adverse Effects of Globalization on SHD

103. The preceding section argued that so far Nepal's integration with the global economy has had only limited effect on growth, income distribution, poverty, gender balance and environment. This is because globalization has so far failed to bring about a major restructuring of trade and domestic production. As this restructuring takes place, as an outcome of the policies recommended above, it is likely that globalization will have important effects on sustainable human development. It is important for Nepal to anticipate the possible adverse effects on SHD and adopt offsetting measures.

Employment

104. Most of Nepal's existing industries, developed under the incentive system of import substituting industrialization, could afford to be inefficient due to the absence of the pressure of international competition.³³ One of the specific forms that this inefficiency took is employment of labour in excess of requirement. This problem was particularly serious in public sector enterprises. As a result of the opening up of Nepal's industries to international competition and the gradual transfer of public sector industries to private ownership, the concealed unemployment in these industries will become open. This process of increased urban unemployment will be exacerbated by the closure of enterprises which fail to remain profitable in the radically different incentive

environment. The process has already set in and is likely to get worse. While in the long run the completion of this process will make industries more efficient, during the period of transition this will aggravate unemployment and worsen the distribution of income. Experience from other countries demonstrates that the transition can be very long.³⁴

105. One way to reduce the detrimental impact of the phenomenon is to improve the growth rate of the economy, thereby increasing the rate of employment growth. This may still prove inadequate for the absorption of all the redundant labour, in addition to the absorption of the natural increase in the labour force. If so, it would call for transitional measures such as public works programmes for the construction of infrastructural capital. In the environment of fiscal retrenchment that accompanies reform for integration with the global economy, it is not easy to finance large-scale projects of this kind. As discussed later, this would require both a restructuring of public expenditure and an improved performance in revenue generation.

Food Price

106. Nepal's exchange rate was devalued substantially vis-a-vis the US\$ during the process of globalization. Since Nepal is a net importer of food, this, along with the reform of the trade regime, resulted in a faster rate of increase in food prices than in other prices. This has adversely affected those large numbers among the poor who are net buyers of food. This problem has been further exacerbated by the rapid rate of inflation, which, though lower during the post-globalization period (about 8 per cent per year in the five years ending in 1996/97) than during the pre-globalization period (more than 11 per cent per year during the 1980s), continues to be high by any absolute standard.³⁵

107. Food prices were suppressed in the past by distortionary policies, e.g., negative effective protection of agricultural exports and low procurement prices for food and agricultural goods in a regulated market. While there is no systematic study of its distributional effect, the removal of these distortions may have adversely affected the rural poor because of the inegalitarian structure of the agrarian economy. The actual incidence of net buyers of food among the poor is not known. But it is likely to be high. Sixteen per cent of all holdings are below 0.2 hectare in size and 43 per cent are below 0.5 hectare. A high proportion of these small holdings can not provide enough food for the families operating them. While permanent wage labour constitutes a small proportion of all workers, 36 per cent of holdings employ casual labour who must buy most of their food.³⁶ Had the distribution of land ownership been more equal, more of the poor would have benefitted from the rise in the price of food. The first best solution undoubtedly is to dismantle the distortions concerning agriculture with a simultaneous redistribution of land. Even if the latter is not feasible, it is quite possible that in the long run the adverse effect of the rise in food prices on the poor would be outweighed by the

favourable indirect effect of higher growth that higher prices would help bring about. In the meantime, it would be necessary to design some action to compensate the net buyers of food among the poor: e.g., an expansion of employment through public works or targeted income subsidy or targeted public distribution of subsidized food.

Agricultural Inputs

108. Exchange rate adjustment and related reform of the trade regime have also increased the cost to the farmers of fertilizer and improved seed causing a reduction in the use of these inputs and a consequent reduction in the growth of agriculture. Slow growth in agriculture has contributed to the adverse trend in poverty in rural areas where most of the Nepalese people live. It also seems to have led to an increased use of environment-hostile agricultural practices. Women have disproportionately borne the consequences of reduced agricultural growth as their participation in agriculture has increased in the age of globalization.

109. An upward adjustment in input prices to their international level is desirable from the standpoint of efficiency. But a sudden rise in the ratio of input cost to output price is a recipe for the reversal of the adoption of modern farm technology which in Nepal had difficulty in taking root in any case. The reduction in subsidies should have been synchronized with the introduction of compensatory measures to preserve the profitability of agricultural production. These measures should have focused on an easier access to credit, an improved provision of extension services and an improved infrastructure for the marketing of output. Once again, the environment of fiscal retrenchment in which globalization has taken place is an obstacle to the implementation of these compensatory measures.

C. Additional Policies for Sustainable Human Development

110. This report started with an account of the low level of human development and the serious problem of environmental sustainability in Nepal. To attain a sustainable progress in human development, Nepal must improve its economic performance. Rejection of the inward-looking development strategy of the past and integration with the global economy are essential preconditions of improved economic performance. As the preceding section documents, integration with the global economy has had and will have (hopefully modest) detrimental effect on several components of SHD during the period of transition which may prove to be rather long. It is therefore essential for Nepal to implement SHD-friendly policies on a broad front, well beyond merely trying to contain the adverse effects on components of SHD of policies for integration with the global economy.

111. This sub-section does not intend to discuss the whole gamut of policies for sustained human development. There are excellent studies available on that subject.³⁷ This part of the report will instead highlight some of the high-priority issues of sustainable human development that go well beyond the globalization policies.

Redistribution of Assets

112. In recent years the effectiveness of egalitarian ownership of assets as a basis for growth with equity has come to be widely recognized. Not only does asset ownership provide the poor households with a vent for productive use of their labour resources, but it also enables them to have access to credit which is often a critical determinant of the ability to undertake indivisible investment which is necessary for the acquisition of human capital.³⁸ In poor agrarian Nepal the most important asset that could enhance the productivity and capability of the poor is land. An egalitarian distribution of ownership of land should also provide important environmental benefit by inducing the poor owners to make labour-intensive investment in the prevention of land erosion.

113. The critical issue is that of the feasibility of an effective land reform. Nepal's past attempts to implement land reform proved as ineffective as similar attempts have proved elsewhere in South Asia and much of the developing world. And yet the recent resurgence of interest in the redistribution of assets as a method of promoting egalitarian growth warrants a re-examination of the arguments for and against land reform in Nepal.

114. A frequently-encountered argument against land reform is that the potential redistributable surplus of land in Nepal is so small that it is not worth the trouble of going through the experience once again. Low land/person ratio is not an argument against land reform. Indeed the most effective land reforms in recent history were implemented in countries with extreme scarcity of land: the Republic of Korea and the Taiwan Province of China (hereafter simply referred to as Taiwan in the interest of brevity). Both these countries have worse per capita land endowment than Nepal. That land reforms in these countries ended up redistributing a very high proportion of total land was a result of a low ceiling of ownership that was imposed. In Taiwan's case the ceiling was about 2.5 times the size of an average farm.

115. Information about landownership in Nepal is extremely murky. The data on the distribution of land for 1981 and 1991, based on Sample Censuses of Agriculture, refer to *operational holdings of cultivated land*, not ownership units.³⁹ If one assumes that ownership distribution is the same as the distribution of cultivated landholding, the institution of a three hectare land ceiling in 1991 - more than three times the average farm size - would provide a redistributable surplus of about 12 per cent of cultivated land.⁴⁰ It is however highly likely that the ownership distribution is substantially more skewed than the operational distribution. As the 1991 Sample Census of Agriculture shows, the proportion of land rented in is inversely related to the size of holding. On the other hand the

incidence of renting seems to be limited; it extends to only 9 per cent of cultivated land according to the Sample Census of 1991. And yet these facts do not provide a complete picture of the distribution of *landownership* because it is not clear if a holding represents the entire land owned/operated by the household that operates it or if it is possible for a household to have multiple farms.⁴¹ If the change in the distribution of landholdings between 1981 and 1991 is extrapolated to the present date, the proportion of land held in farms above 3 ha would of course be smaller; but there is no *a priori* reason to believe that the same has happened to the ownership of land. The upshot of the above is that, given the existing state of knowledge, it is impossible to determine the distribution of landownership and the potential redistributable surplus of land in Nepal with confidence. It is however quite possible that an effective accounting of landownership and the enforcement of a sufficiently low ceiling of ownership would generate a redistributable surplus which would be substantially in excess of what is implied by the 1991 distribution of *holdings*.

116. As the Taiwanese and Korean experiences demonstrate, a large potential redistributable surplus of land is not enough for a successful land reform. These countries had certain other special advantages. One can illustrate this with reference to the Taiwanese experience.⁴² The government had come to own about 20 per cent of the total cultivated land as an windfall from the defeated Japanese colonial landowners. Thus approximately 50 per cent of redistributed land was obtained by the government at no cost at all. Secondly, 30 per cent of the compensation paid to the landlords was financed by giving them shares in the four large industrial enterprises that the government had received as windfall from the former Japanese colonial owners. Although a very high proportion of the cost of redistributed land was financed by land and assets left behind by the Japanese, there was a very large element of confiscation in the procurement of land from the private landlords who, as noted above, were allowed to retain a maximum of 3 *chias* (2.91 ha) of land and made to surrender the rest at a price that equaled only 2.5 times the annual net output value. That the government was able to command the political will to impose these harsh measures on the landlords was due to its complete autonomy: the Guomindang government, which had fled the mainland and captured Taiwan, owed nothing to the Taiwanese landlords and had no incentive to serve their interest.

117. These conditions do not obtain in Nepal. How might then circumstances be made favourable for the successful East Asian kind of land reform in Nepal? One possible solution is for Nepal to receive external resources from donors equivalent to something like what Taiwan received as windfall due to the exodus of the defeated Japanese rulers. These resources could be made available specifically to finance Nepal's land reform. Substantial compensation, tied to the ownership of non-farm enterprises, could mute political opposition to very low ceilings on landownership which is necessary to generate a meaningful redistributable surplus of land. Over a period of time, the recipients of land could repay a good part of the value of land. With complementary investment in infrastructure, research and price incentives, Nepal could finally have its long-delayed green revolution, reverse land degradation and create a solid base for egalitarian growth. The tying of

compensation to non-farm entrepreneurship could also trigger rapid growth in industries and services. It is however important for the development community, both in Nepal and abroad, to realize that mere exhortations about the virtue of land reform and call for political will for its implementation will prove empty without an injection of resources. The pay off will undoubtedly justify the injection of resources. Working out the details of this proposal is itself a significant undertaking. This could be taken up once there is enough interest among the Nepalese authorities and the international development community in the idea.

Redistribution of Incremental Assets

118. It is easier to redistribute new assets - or rather create new assets for the poor - than to redistribute existing assets. This is most effectively done by endowing the poor with the human capital assets, that enhance their productivity both in self employment and in wage employment, and with the ownership of microenterprise, i.e., enterprises that require little physical asset. Nepal has made commendable progress in primary education. This should be complemented by a wider access on the part of the poor and the women to secondary education and education and training specifically crafted to facilitate employment in activities that are targeted for promotion. This presupposes the existence of a system of assessing the growth in demand for different kinds of skill and the creation of capacity for the dissemination of these skills. This system should be based on a regular interaction between the government and private business and the delivery of education and training services should utilize public, private and NGO resources.

119. An essential link in the process of creating new assets for the poor is the improvement of the access of the poor to credit. According to the 1991 Credit Survey, 39 per cent of the rural households resorted to borrowing while the remaining 61 per cent did not. This probably represents a vast unsatisfied need for credit rather than an absence of such need. Of the borrowing households, 87 per cent borrowed from the informal sector while 21 per cent borrowed from formal institutions (eight per cent borrowing from both sources). The interest rate charged in the informal market ranged from 36 per cent to 43 per cent.⁴³ While these rates are not as outrageously high as is reported to be the case in many developing countries, there is a need to bring them down by an expansion of credit through formal institutions.

120. Microfinance is provided by the Agricultural Development Bank of Nepal (ADB/N) and NGOs which target households with very small landholding. Commercial Banks have hitherto been required to earmark 12 per cent of their lending to priority sectors (agriculture, cottage industry and rural services) and three per cent to the very low-income households. Recently the Rural Microfinance Development Centre (RMDC) has been set up to service the formal lending institutions for rural microenterprise. The RMDC will begin operation in the near future. It will receive funds from the Asian Development Bank, channeled through the government, at 6 per cent interest and lend to the microfinance institutions at 9 per cent in the expectation that the latter would

lend to poor households at 20 per cent. A large enough network of formal credit outlets under these terms will bring down the interest rate in the informal market and be of great benefit to the poor households if additional cost of transaction is insignificant. The success of the programme will depend on the ability of the microfinance agencies to reach the poor households by overcoming the absence of collateral; providing adequate supervision and support to make success of microenterprises backed by credit; limiting default; and covering the cost of operation by the margin of 11 per cent of the fund lent.

121. Access to transport and other infrastructure is another critical link in the process of creating assets for the poor. Available evidence shows that the intensity of poverty and the distance from roads are highly correlated.⁴⁴ This calls for an expansion of the road network to poor locations. This is likely to be highly intensive in investment involving indivisibilities. There is at best a limited opportunity for the targeting of these public goods; while they can be targeted to poor *areas* they can not be targeted to poor *households*.

Employment

122. The process of integration with the global economy as outlined above implies a development strategy of which the promotion of activities in which Nepal has potential comparative advantage is the central component. These activities will necessarily be intensive in the use of Nepal's abundant factor, labour. Rapid expansion of employment is therefore the centre-piece of the development strategy in the context of which Nepal will pursue its policy of integration with the world economy. And yet, as emphasized above and is documented by the experience of countries which have preceded Nepal along this path, there is a danger that during the period of transition Nepal will face the problem of large-scale retrenchment of labour in many industries that were developed under the past ISI regime. To deal with this problem Nepal should consider public works programmes for capital construction of substantial proportions. These programmes should be carefully designed to implement the investment needs for sustainable human development: e.g., construction of rural roads; land improvement; and schemes for the protection of environment.

Public Expenditure for Human Development

123. Enhanced health and educational capability requires increased expenditure on these services. Private expenditure on these services will increase as incomes of households rise and poverty declines. But these components of expenditure provide large-scale externalities. Private demand alone would therefore result in an inadequate production and absorption of these services. Public expenditure must supplement private expenditure to ensure an adequate magnitude of these services. As noted above, Nepal has successfully prevented a decline in the share of these sectors in total public expenditure. But the share of these services in total public expenditure is low in Nepal by international standard and by the standard of what has come to be regarded as the target set by the

world community. Despite Nepal's success in increasing the share of education and health in public expenditure, public services in these sectors suffer from serious problems. For example: in education there is a big gap in quality between public and private institutions which needs to be bridged and public health services in rural areas suffer from the problem of absenteeism on the part of the medical personnel. Overcoming these problems will require additional resources.

Safety Net

124. The measures that have been proposed above should provide protection to most members of the society. And yet there will remain some for whom these measures will prove inadequate. Examples are: labour-poor households, households afflicted by disability and communities in remote locations which can not be reached by the programmes and policies outlined above. Nepal is too poor to provide for conventional social protection for these groups. It should consider creating a system of community level programmes for the protection of these groups. A promising avenue is to provide fiscal incentives to local communities and NGOs who provide necessary services to poor households that fall in this category.

Financing

125. Some of the programmes outlined above - notably the transitional programmes for public works, increased public expenditure for social sectors and supplementing community effort for the protection of the vulnerable - will require additional public resources which might put pressure on Nepal's macroeconomic balance, both external and domestic. One of the major themes of this paper is that Nepal could profit by a moderate widening of its external imbalance which would allow the NR to achieve a desirable depreciation vis-a-vis the IR that will ultimately have a self-correcting effect on external balance. Domestic budgetary balance must however be found by a combination of restructuring of public expenditure and an augmentation of public revenue. Careful analysis of these possibilities is an indispensable prerequisite of a balanced strategy for sustainable human development.

VI. THE ROLE OF UNCTAD AND UNDP IN FACILITATING AN SHD-FRIENDLY INTEGRATION WITH THE GLOBAL ECONOMY

126. Nepal's integration with the world economy with sustainable human development amounts to a massive agenda incorporating large-scale regional cooperation; action by immediate neighbours; cooperation of the international community; and, above all, domestic policies encompassing virtually all aspects of economic incentives and institutions. There are important ways in which the UNCTAD and the UNDP can assist Nepal in this transition. The nature and contents of the assistance that these two agencies can provide will unfold as the process of globalization makes progress. At this stage one can highlight some of the obvious areas of cooperation.

- As the perusal of this report makes clear, Nepal does not have an adequate system of monitoring human development. Even such straightforward indices as income distribution and income poverty can not be measured consistently over time. Nepal urgently needs to institute a periodic - biennial or triennial - sample survey to monitor income, expenditure and other individual and household characteristics according to a methodology that permits comparison of indicators over time. This could be done by augmenting the capacity of the Central Bureau of Statistics (CBS) to implement such surveys. The UNDP could provide necessary hardware and technical resources to create this capacity.
- Integration with the global economy has put additional burden on Nepal's institutional capacity for international negotiations concerning WTO membership; regional cooperation and a variety of other matters. Nepal must also keep abreast of the implications of WTO rules for its policies for the promotion of industries and exports. It also needs help in participating in negotiations for the evolution of the architecture of globalization following the Seattle meeting of the WTO. The UNCTAD has a great deal of expertise in these matters. Its analytical work on many of these questions is already of very considerable help to countries like Nepal. There is however a case for regular institutionalized technical support by the UNCTAD. Priority areas of support include: an enhancement of the capacity of the Trade Promotion Centre; periodic training seminars for the officials of the Ministry of Commerce about specific aspects of multilateral trade negotiations; information hotline for rapid response to queries on trade issues; and training on negotiations with multinationals concerning FDI and intellectual property.

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NOTES

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1. Purchasing power parity \$ estimates for Nepal are indirect and subject to substantial error.
 2. This section provides only a brief summary. For a more detailed account see Bajracharya, 2000.
 3. It is customary for the World Bank to report fiscal year data by indicating the calendar year in which the fiscal year ends. Thus the year 1997 means the fiscal year ending in July 1997. Unless mentioned otherwise, a calendar year means the Nepalese fiscal year ending in mid July of the year shown.
 4. Of the 43 countries classified by the United Nations as least developed, 32 are in SSA.
 5. The data on per capita income and the gender difference in life expectancy are from World Bank, 1999. All the other data in this and preceding paragraphs are from UNDP, 1999.
 6. See Bajracharya, 2000.
 7. UNDP 1999. Estimate for India is not available. For Sri Lanka too the rate of improvement in HDI has been lower than in Nepal; but this comparison is not meaningful because Sri Lanka, with a qualitatively higher HDI, must make far greater effort to attain an increase in it by a given per cent than Nepal.
 8. World Bank, 1999.
 9. See Karmacharya, 2000 for a summary.
 10. See Bajracharya, Sharma and Osmani, 1999.
 11. Bajracharya, 2000 reports these Gini ratios which are based on the Nepal Rashtra Bank (NRB) Survey for 1985 and Nepal Living Standard Survey (NLSS) for 1996. It is not clear how comparable are the concepts of income in these two surveys. The increases in the Gini ratios are, however, very large: from 0.26 to 0.43 for urban areas and from 0.23 to 0.31 for rural areas. These increases are too large to be explained by minor differences in definitions and concepts.
 12. For a detailed account of these arguments and references to various sources see Islam, Khan and Lee, 1982.
 13. This is why India's granting of rights for Nepal to transit to Indian ports and to Bangladesh by itself is of very little significance without a lowering of the cost of access to the markets of the rest of the world through Indian or Bangladeshi ports.

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14. These are discussed in details in the background paper Karmacharya, 2000.
15. The figure for 1997 is from World Bank, 1999.
16. World Bank, 1999.
17. That these liberalization policies are not a precondition for successful and vigorous export promotion is illustrated by the case of China.
18. World Bank, 1999 reports an FDI inflow of \$ 23m in 1997.
19. India recently decided to enforce its Food Act to subject edible imports to laboratory testing as a safeguard against adulteration. The nearest food testing laboratory in Calcutta being almost a thousand kilometers away from the main customs point at Birgunj, this not only raised the cost of export but also affected its quality. India has more recently responded to Nepal's complaint by opening food testing laboratory in Patna.
20. In Nepal, one often encounters the argument that the appreciation of the NR, vis-a-vis the IR, does not affect Nepal's exports to India as is shown by the rising share of India in Nepal's exports in the period in which the currency appreciation has taken place. This is hardly a convincing argument. The rise in India's share of exports may be due to a variety of factors, e.g., the rise in the ratio of recorded to unrecorded exports and the reduction in relative incentive for exports to hard-currency countries due to the radically altered trade regime. This does not indicate that a more competitive exchange rate would not result in greater exports to India. The argument that the elasticity of supply of exports is low is not an argument against the avoidance of an appreciation in the exchange rate, but an argument in favour of improving the elasticity of supply of exports. An example of possible inhibition of exports to India due to the appreciation of the NR is the recent report of a drop of tourists from India (*The Kathmandu Post*, December 16, 1999, p. 1). Rijal, 2000 reports that the growth rate of foreign exchange earning from tourism during the globalization period was only half of that during the pre-globalization period. It is hardly conceivable that a depreciation of the NR will have no effect to reverse this.
- 21 The periodization adopted in this table differs from the periodization adopted in the background studies which usually designate the entire period since 1991/92 as the single globalization period. In this paper this period has been divided into an earlier and a later sub-period. This is because the full effect of integration with the global economy could not possibly have accrued in the earlier sub-period.
22. Shakya, R. K., 2000.
23. Some sources suggest that the increase in the rate of investment in recent years has been much slower than what is claimed by the official data. Thus Asian Development Bank (ADB) 1998,
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reports investment rates for 1995, 1996 and 1997 to be respectively 23.4 per cent, 23.2 per cent and 23.4 per cent. The reasons for the difference between these estimates and the official estimates could not be ascertained.

24 Karmacharya, 2000 quotes employment data from ILO and CBS sources to show that the Aemployment growth≡ rate in agriculture during the post-globalization period was nearly six times the employment growth rate in agriculture during the pre-globalization period! It is probable that the statistical estimate of Aemployment growth≡ actually represents the rate of increase in labour absorption or labour supply. More on this below.

25. During the first seven years of the 1990s, value added in agriculture increased at 2.2 per cent per year. Terms of trade for agriculture appears to have declined. While nothing is known about the growth in non-farm rural income, it is unlikely to have been completely out of line with the growth in agriculture which provides the major linkage that induces much of the growth of rural non-farm activities. Rural population probably increased at close to 2.25 per cent per year.

26. See Bajracharya, Sharma and Osmani, 1999. The evidence of a slight reduction in poverty in rural areas over this period is based on a comparison of the findings of the 1991 Rural Credit Survey and the 1995/96 NLSS.

27 See Tables 1.4 and 1.5 in International Labour Organization (SAAT), 1997 for estimates and sources.

28. ILO (SAAT), 1997 shows that for 1991 employment estimates were from CBS= Population Census while for 1996 they were from the LSMS. The two sources use very different methods.

29. The sources of the evidence are shown in Bajracharya, 2000.

30. In measuring the size of the market, purchasing power at market exchange rate, rather than purchasing power parity, should be the relevant indicator. Using the exchange rate, the size of the Nepalese market is approximately US\$ 5 billion which is less than what one gets by multiplying the US per capita GDP (which is probably an underestimate of the per capita GDP for Riverside) by the population of Riverside (just over 200,000). Indeed, a very high proportion of Nepal's market is committed to the consumption of subsistence goods and services, leaving an uncommitted market size that is far smaller than that of Riverside.

31. The author of this report was informed by the Ministry of Commerce that such promotional measures are already in place for Nepal's exports. Thus exporters who have LCs in hard currency are apparently eligible for credit at 7.5 per cent interest as compared to the usual 12 per cent rate. It is not altogether clear how this preferential interest is financed. It appears that this is financed by foreign exchange deposits which also receive a low interest because of the absence of an exchange

rate risk. If the "preferential interest" is for loans in foreign exchange, for which the borrower bears the exchange rate risk, then this hardly constitutes a preference.

32. It has been alleged that Nepalese export of lentil to Sri Lanka was driven out by Turkey's dumping of lentils at subsidized prices.

33. There was of course competition from industries in India across the open border; but Indian industries, fostered in an ISI environment, were subject to similar inefficiencies.

34. The adverse distributional consequence of the phenomenon is most dramatically illustrated by China where the period of integration with the global economy has witnessed a catastrophic increase in urban inequality largely due to the shedding of concealed unemployment by the state and collective enterprises. See Khan, A. R. and Carl Riskin, 2000.

35. For an elaboration of these arguments, see Guru Gharana, 1996.

36. These facts are from Central Bureau of Statistics, 1994. They refer to the year 1991.

37. See, for example, NESAC, 1998.

38. See Deininger and Squire, 1996, for an account of the argument and the evidence.

39. This is very clearly stated in Central Bureau of Statistics, 1994. For example, page 28 says that 83 per cent of *holdings* were fully owned, 15 per cent were partly rented and 2 per cent were fully rented.

40. There were 127,000 holdings above 3 ha with an average size of 5.37 ha. This means that a ceiling of 3 ha would release 301,000 ha which was 11.6 per cent of 2,597,000 ha of total cultivated land.

41. Agricultural censuses usually show the distribution of *farms* of which more than one may be owned/operated by a single household.

42. For an account of Taiwan's land reform see, Kuo, Shirley, Gustav Ranis and John Fei, 1982.

43. Information in this paragraph has been reported more fully in Shakya, 2000.

44. World Bank, 1998 quoted in Shakya, 2000.