

# Structural Transformation and Economic Growth in Nepal:

## What has changed? : Ramesh Paudel and Swarnim Wagle



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Right: Dr. Swarnim Wagle

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Swarnim Wagle, PhD is an economist served as the 24th Vice-Chair of the National Planning Commission (NPC) in the Government of Nepal. Dr Wagle worked as an international development professional for more than 15 years on policy assignments in over 20 countries. He co-authored the 2013 Human Development Report titled "The Rise of the South" in the United Nations Development Program (UNDP). He holds a PhD in Economics from the Australian National University, MPA in International Development from Harvard University, and a B.Sc. (Econ.) from the London School of Economics.

### *Context*

The story of Nepal's economic growth is one of disappointment relative to potential: physically beautiful, geographically perched between the world's largest and fast-growing economies, a young democracy, international goodwill, competitive strength in generating clean hydro-powered energy in an era of climate change, and a demographic dividend with almost 40 percent of the population accounted for by the youth.

Nepal's real per capita GDP grew at an anaemic rate of 1.8 percent per year, on average, between 1965 and 2014. The growth of about seven percent in 2017-18 does not yet mark a structural break. It is still not clear that the growth of latter years is a bubble, or the country is finally acquiring a momentum for growth. Relative to the performance of several countries in the South Asian region (see Table 1), Nepal has fared dismally, trapped in chronic poverty.

Table 1 shows a pattern of the economic growth history of Nepal compared to its regional neighbours. Here, the northern neighbour, China, is incomparable at this stage looking the history of growth in the last five decades. If we look only South Asian countries, we find that despite above mentioned favourable situation for growth, Nepal remains the poorest country in the region except Afghanistan as of 2018. This table shows two other important points: first, if we look at the data since 2010, Nepal's performance is better than only of Afghanistan, Maldives, and Pakistan but the differences are not big. In the same context, Bangladesh and India are doing better than Nepal. Thus, the changes in terms of economic growth/performance are very nominal.

**Table 1: Nepal's per capita GDP (constant \$, 2010) as a share (%) of other countries, 1970-2018**

	1970	1980	1990	2000	2005	2010	2015	2018
Afghanistan					140	109	127	145
Bangladesh	69	78	86	87	81	76	73	68
Bhutan		69	44	39	32	26	26	26
India	72	66	61	55	48	44	42	39
Maldives				8	9	8	10	10
Pakistan	60	51	48	55	54	60	68	68
Sri Lanka	40	31	30	25	23	21	20	21

*Source: Authors' calculation based on World Development Indicator database, World Bank (2019).*

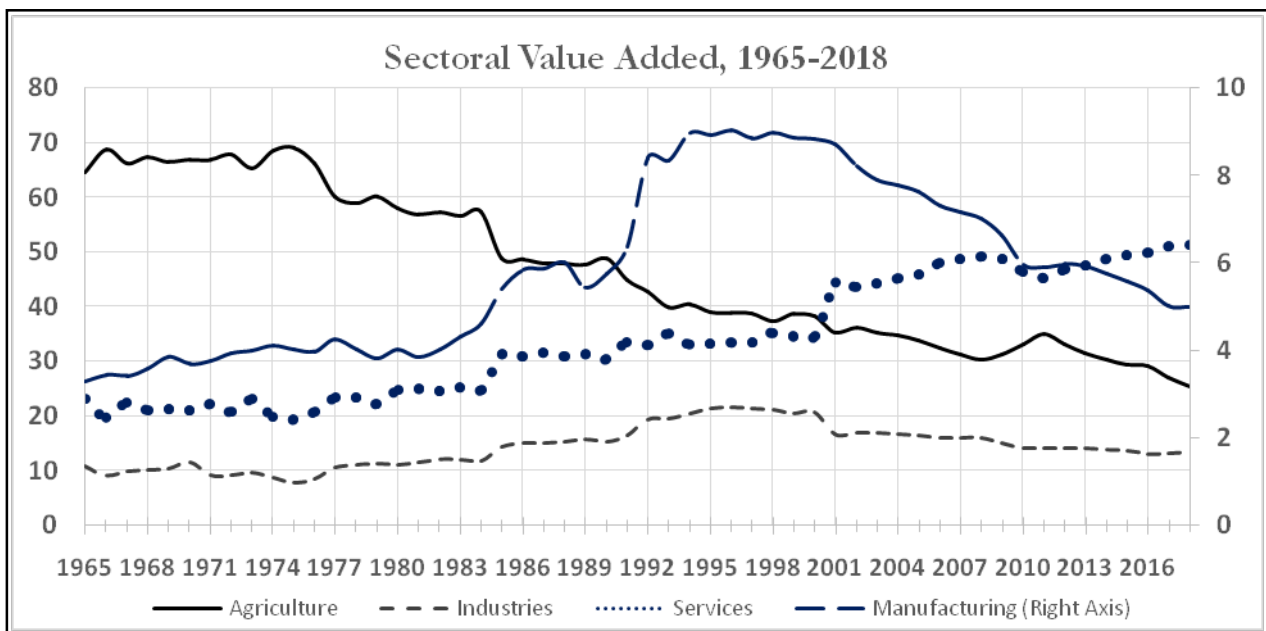
### **Structural transformation of the Nepali economy**

Analysis of the structural transformation is a key task to understand the dynamics of a country's economy. The nature of structural transformation of Nepal reflects a unique pattern compared to that of other developed countries which passed through a similar development phase of Nepal few decades ago. The uniqueness is that our transformation jumped to service sector from agriculture without shifting to manufacturing sector in terms of the contribution in gross domestic products (GDP).

Figure 1 is presented employing the relevant data for the period of 1965 to 2018. The value added from Agriculture, Industries, and Services are measured in the left axis, and of the manufacturing sector in the right axis. As seen in the figure, the value added in GDP from agriculture is declining consistently since 1974 with some negligible fluctuations. This share of loss is recovered by service sector. Unlike in other developed countries, the path of Nepal's structural transformation seems from agriculture to service sector instead of agriculture to manufacturing/industries to service sector. The situation of manufacturing sector (right axis) is not impressive and has hovered below 10 percent throughout this period.

There was a little hump in the early 1990s but started declining since the early 2000s. Notably, since then the economy is largely depending for current expenditure on remittances as the service sector extends to the agriculture sector from the same points. The situation is the result of the expansion of banking and financial sector, wholesale and retail trade, health and education sector. These sectors also are highly related with the expansion of the remittances base. The difference between industries and manufacturing is due to the inclusion of construction, mining, and electricity in the industrial category.

**Figure 1: Sectoral Value Added in GDP (%), 1965-2018**



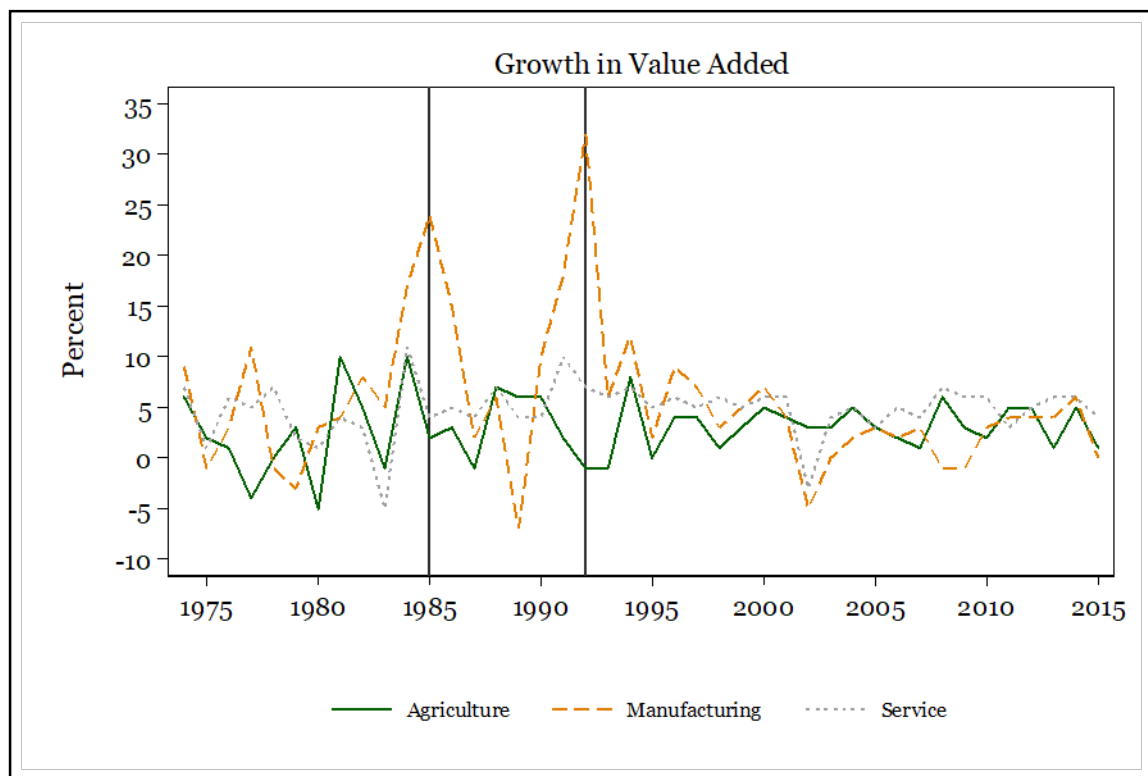
*Source: Authors' calculation based on World Development Indicator database, World Bank (2019).*

Further, if we look at the growth sectoral value added as seen in the Figure 2, all sectors' growth is almost similar as of the 1970s, even lower than that of the 1970s level, again with some fluctuations of manufacturing sector as discussed earlier.

This clearly indicates that productivity growth of any sector is virtually nominal. This is the reason for poor economic performance of the economy. This also shows that only the investment is shifting from agriculture to service sector, that may shift again immaturely to agriculture or elsewhere. Therefore, the productivity growth of the relevant sectors should be in the top priority of the policy makers of the country.

Another important information from this graph is that the manufacturing sector, since the early 2000s, is the most lagging sector, which could provide employment to unskilled and semi-skilled labour force. Because of this scenario, the number of workers seeking foreign unskilled jobs has increased substantially. The sustainable growth is a difficult task without understanding these facts, dynamics and nature of contributing sectors.

**Figure 2: Growth of sectoral value added, 1974-2015**



*Source: Paudel and Waglé (2019).*

### ***Some potential pathways***

The problems in Nepali agriculture and manufacturing sectors are well known. The nation continues to rely on rain-fed traditional agriculture, with less than one-fifth of cultivable land irrigable throughout the year. Public inputs, such as fertilizers, seeds, research & extension services are woefully inadequate. Complementary infrastructure, in the form of rural roads and electricity are expanding but have not reached the levels necessary to support commercialization and

the reaping of scale economies. On the same path, manufacturing sector suffers from policy inconsistencies, strategic weakness and additional costs of trade due to land lockedness (Paudel and Cooray, 2018). Infrastructure quantity and quality are both inadequate.

Financing instruments remain unsophisticated with the reach of concessional credit and insurance still largely confined to urban and peri-urban areas. Largely, none of the financial and insurance products are designed to suit the agriculture and manufacturing sectors. Without improving the quality of governance, these problems would remain largely unsolved.

Part of the challenge is that investments going into both agriculture and manufacturing sectors have declined over decades and have marked only a modest uptick in recent years, in contrast to manufacturing which is shrinking in relative terms (Table 2). This is problematic because agriculture and manufacturing remain sectors that can provide gainful employment to the masses. Because they are not expanding and not absorbing young people in large numbers, Nepal has seen outmigration on an epic scale over the past decade. In 2016, about 40,000 people left the country every month, on average, in search of temporary employment opportunities abroad.

In recent years, a new form of agriculture is actually picking up in urban areas even as it shrinks in rural areas. Self-employed agriculture is, in fact, the largest sector of employment in urban areas. We hypothesize that this could be a result of migrant returnees who do not choose to return to their villages but instead apply their knowledge, exposure and capital to a new vocation, particularly in the Kathmandu Valley and surrounding areas like Kavrepalanchowk, Nuwakot, Dhading, Makawanpur, and Gorkha districts. The policy makers should understand these dynamics in the trend of the economic sectors and plan accordingly to go ahead.

**Table 2: Sectoral investment (percent of total investment)**

Year	Agriculture	Manufacturing	Services
2010	11	12	77
2011	11	11	78
2012	11	11	78
2013	11	10	79
2014	12	9	79
2015	13	6	81

*Source: Aryal (2016)*

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