Sources of Growth, Factor Returns and Sustained Growth: A Comparative Study of Primary, Secondary and Tertiary Sectors in Nepal

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Background

- Except during the first half of 1990s, growth performance of the Nepalese economy far from satisfactory:
  - Average growth rate hardly 4 percent during the period 1975 to 2010 and even lower during the post liberalization period.
  - Real state, finance and some social services sectors performed relatively better in the liberalized regime.
- Export performance worsened as its share in GDP reduced to 9.8 percent in 2010 from 24.2 percent in 1995.

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- Gross fixed investment below 20 percent of GDP after 1995.
- Domestic saving to GDP ratio 7.4 percent in 2010 from 15.2 percent in 2000 and remittances and other inflows meeting widened external or internal resource gap.
- Productive employment a major problem as around 94 percent of work force in informal sector.
- A large gap between income and consumption level by decile groups with questions on the robustness or precision of consumption based poverty estimates which show steady decline in poverty and also inequality recently.
- For instance up to third decile group's cons higher than income in 1996 where as in 2011 up to 6^{th} decile group. Consumption poverty in 1996 41.76 %, in 2004 30.85 % and in 2011 25.16 % . Likewise consumption based inequality 0.322, 0. 414 and 0.328 respectively.

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- All these raise some basic questions:
  - Why despite more liberalized and open up policy regime regarded to be key for sustainable higher growth could not be ascertained in Nepal?
  - Are policy and institutional lapses major constraining factors for total factor productivity growth again assumed to be the major channel of higher growth under the liberalized/ free trade regime?
  - Is factor return and distributional dimensions equally important ingredient of sustained high growth in countries like Nepal?

Scope of the Study

Accordingly, the scope of the study was:

- Review of major economic policies and their performance.
- Identify major sources of economic growth in primary, secondary and tertiary sectors and derive determinants of total factor productivity in these sectors before and after liberalization and more importantly evaluate the effect of economic policies on total factor productivity.
- Analyze effect of intra and inter sectoral input reallocation on sectoral productivity growth .
- Analyze factor returns in terms of returns to labor and capital and assess distributional gains or losses taking sustained growth into consideration.
- Carry out diagnostic survey among key informants to verify quantitative analysis based findings and get policy feed backs, and
- Draw some policy inferences.

Methodology

- Both qualitative and quantitative methodological approaches followed covering the period 1975 to 2010 with further breakdown between pre-liberalization (1975-1990) and post liberalization (1990-2010) period. More specfically:
  - A qualitative analysis of economic policies.
  - A comparative analysis of major macro and sectoral indicators.
  - Rigorous quantitative analysis using Cobb-Douglas constant returns to scale production function to delineate sources of growth and factors influencing them.
  - Use of productivity decomposition method as suggested by Taylor to examine the probable effect of intra-inter sectoral reallocation of traditional inputs.
- A perception survey to cross check the findings and get feedbacks from concerned stakeholders.

An Overview of Economic Policies

Economic policy review showed that:

- **Fiscal Policy**
  - Top priority on fiscal balance and economic stabilization and privatization initially.
  - Emphasis and various measures on rationalization of tax system under which sharp reduction in dispersion rates, introduction of VAT (1995), new income tax law (2001) and administrative and institutional reforms .
  - Public expenditure reforms directed to prioritize resource allocations and improve public exp management.
  - Some tax concessions or rebates to both domestic and foreign enterprises.

- **Monetary Policy**
  - Policy mainly driven by price control and BOP stabilization.
  - Financial sector liberalization focus through deregulation in interest rate, flexible exchange rate with hard currencies, abolition of priority sector lending etc.
  - Permission of up to three fourth foreign equity participation in banking and free entry to whole sale banking.
  - Thrust on prudential regulation and financial stability , priority sector and deprived sector lending and financial inclusiveness recently.

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e toward trade liberalization as part of WTO membership
bilateral and regional agreements also govern the trade relations.

/ liberalized as tariff one of the lowest in South Asia (average tariff
.2 percent).

ıx except service charge, income tax on exports exempted, no
ed policies distorting export trade, free movements of imports
banned items and no quota restrictions on imports.

alization of both goods and services trade going on.

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separate policy as such various related policies aimed at creating
/ironment to both domestic and foreign investors. Among them
able :