

## Unit 4

### Economic Environment

#### **Economic Dimension of Nepalese Economy:**

It includes gross national product, per capita income, personal consumption and expenditure, personal ownership of goods, inflation rates, private investment, unit labor cost and level of employment. As per the Economic Survey 2014/15 the economic dimension of Nepal is as follows:

1. The GDP growth is 3% (contracted by 2.1% at basic price) on 2014/15 as compared to last year which was 5.1% in 2013/14. The contraction is due to low growth rate of agriculture and impact of April 25 earthquake and subsequent aftershocks.
2. The average inflation rate stood to 7.2 % in 2014/15, which is reduced by 2.1% as compared to last year. The fall in inflation rate is due to fall in price of petroleum products in international markets.
3. The overall BoP was in a surplus of Rs 127.20 billion in 2014/15. This is due to increase in remittance by 11.2 % to USD 5.55 billion in this period.
4. In the review period, total trade deficit expanded by 8.7 percent to Rs. 612.87 billion. Such deficit had increased by 28.6 percent during the same period of the previous year.
5. The gross foreign exchange reserves increased by 21.7 percent to Rs. 809.48 billion in mid-June 2015 from Rs. 665.41 billion in mid-July 2014. Based on the trend of imports during the eleven months of the review year, the existing level of reserves is sufficient for financing merchandise imports of 13.1 months, and merchandise and services imports of 11.3 months.
6. Despite the decline in the number of Banks and financial institutions (BFIs) due to merger and acquisition, financial access has been widened due to branch expansion as well as an expansion of some products such as mobile banking and branchless banking.
7. In this year, production of paddy (rice), which contributes 21 percent to agriculture GDP, has declined by 5.1 percent owing to adverse climate. Likewise, production of maize (corn) among the major crops is estimated to have declined by 6.0 percent as well. In FY 2014/15.
8. The fishery sector is estimated to grow by 6.3 percent in the current fiscal year 2014/15 as compared to 4.9 percent growth in the previous fiscal year.

9. Performance of manufacturing sector has not been satisfactory during the last decade. Manufacturing sector has been adversely affected for long due to lack of improvement in the investment environment; persistent energy crisis; uneasy labor relations; ever extending political transition.

### **Issues and Challenges**

- a. Macroeconomic stability is influenced by both internal and external factors. Along globalization, economic growth, inflation, and trade like macroeconomic variables get influenced by external happenings and incidences. In the context of globalization, external sector has been posing numerous challenges against maintaining macroeconomic stability.
- b. Agriculture sector has occupied one third share in GDP. Fluctuations in agriculture GDP has been affecting overall economic growth rate. In the context of Nepal's vulnerability of agricultural production on favorable/unfavorable climatic conditions, achieving higher growth rate through sustainable development of this sector has been a 17 persistent challenge. Likewise, non-agriculture sector has also been affected as a result of failure to expand domestic and foreign investments to desirable extent owing to factors like political instability, labor problem, energy crisis, weak infrastructure and failure to achieve desired progress in investment environment. Hence, it has been a daunting task to improve investment environment and achieve higher economic growth rate by bringing ever extending political crisis to an end.
- c. High and sustainable economic growth is a must criterion for Nepal to graduate from a least developed country to developing country by 2022. It is difficult for the country to graduate to the status of developing country unless it achieves a consistent annual economic growth rate of 7-8 percent. Amidst country's average economic growth rate of just 4.1 percent in last five years, achieving the target with the attainment of higher economic growth by boosting investment remains a challenge.

### **Concept of Monetary Policy**

“Monetary policy is the management of the expansion and contraction of the volume of money in circulation for the explicit purpose of attaining a specific objective such as full employment”. (Kent)

The objectives of monetary policy are as follows:

- a. To stabilize the price level since fluctuations in prices being uncertainty and instability to the economy.
- b. To increase investment for full employment.
- c. To have the rapid economic growth with stability.
- d. To maintain equilibrium in the balance of payment.

### **Current Monetary policy of Nepal (2014/15):**

The monetary policy 2014/15 introduce several measures such as checking inflation, increasing Cash Reserve Ratio (CRR), increase in paid up capital for banks and finance companies, increase loan loss provision etc. to strengthen and ensure the economic development of Nepal.

Following are the objectives of Monetary Policy 2014/15:

- a. Maintaining price stability by managing excess liquidity.
- b. Expand credit to the productive sectors.
- c. Maintain financial sector stability.

**Privatization:** It is the process of transferring of ownership property or business from the government to the private sector. Privatization is considered to bring more efficiency and objectivity to the company, something that a government company is not concerned about. In Nepal, privatization efforts were initiated in early 1990s from sixth plan.

Objectives of privatization:

- a. Effective mobilization and utilization of resources.
- b. Increase competitiveness of organizations.
- c. Government budget improvement.

Methods of Privatization: Following are the methods of privatization:

- a. Assets Sales: Under this method, the production and service units and other assets of enterprises are transferred to the private sector in return for a price. Assets are sold through public auctions.
- b. Business sales: Under this method, the total ownership of public enterprises is transferred to the private sector.

- c. Share sales: It involves the transfer of share to the general public, employees and private organization.
- d. Management contract: It involves transferred of management right to the private sector for a temporary period of time. The main objective of such process is to improve the productivity of the public enterprises.
- e. Lease assets: Under this method, government provides right to the private sector to use the property. It is temporary in nature and private sector should pay the lease amount for its usage.

**Liberalization:** It is the removal of government control to encourage private participation and economic development.

“Economic liberalization means freeing of prices, trade and entry to markets from state control while stabilizing the economy. (World Bank)

In Nepal liberalization policies were implemented from 1990 with higher emphasis on privatization and open market policies. Different policies like Industrial Policy, Foreign investment Policy, Labor Act etc. promulgated and implemented to support liberalization in Nepal.

**Requirements of Liberalization:**

Following are the requirements for liberalization:

- a. Role of the government as the facilitator
- b. Increased role of private sector
- c. Abolishing license requirements
- d. Freedom in business decision (establish and liquidate business )
- e. Removal of restriction (movement of goods within and between countries.)
- f. Reduction of tax rate (corporate tax, tariffs etc)
- g. Simplification of foreign trade.
- h. Facilitate FDI and technology transfer
- i. Current account and capital account reform ( current a/c reform: making foreign exchange convertible, capital a/c reform: maintaining account in convertible currencies)

## **Internal and External Liberalization**

1. Internal liberalization: It means reducing the restriction in business operation. It can be done in various forms:
  - a. Financial sector reform: The main objective behind financial sector reform is to create financial stability and economic development. It includes:
    - i. Deregulation of investment rate ,which can allow banks to determine the interest rate under certain range given by central bank.
    - ii. Restructuring of government owned banks like Nepal bank limited and Rastriya Banijya Bank.
    - iii. Enactment of different Nepal Rastra Bank Act.
    - iv. Banking sector is opened for foreign investment. Etc.
  - b. Fiscal reforms: These reforms include, reform in tax, convertibility of Nepalese currency etc.
    - i. Introduction of VAT
    - ii. Private sector is allowed to borrow money from foreign source etc.
  - c. Monetary policies: It includes deregulation in interest rates, foreign exchange rate etc.
  - d. One window policy: Providing every business service from a single place for prompt services.
  - e. Removal of subsidies
  - f. Insurance sector reform
  - g. Capital market reform etc.
2. External Liberalization: It includes liberalization on trade and foreign exchange sectors.
  - a. Reforms in trade sector
  - b. Reforms in foreign exchange
    - i. Current account reform
    - ii. Capital account reform

### **Effects of liberalization on Nepalese Business:**

- a. Growth of private sectors
- b. Rise of financial institutions

- c. Increase in FDI
- d. Rise of MNCs
- e. Rising trade deficit
- f. Development of capital market and insurance
- g. Changing role of government
- h. Changing market scenario.

## **An overview of Nepalese Industrial Sector**

### **1. General Overview:**

- Government target to uplift from least developed country to developing country by 2022.
- Industrialization begins in Nepal from 1936 by the establishment of Biratnagar Jute mills, Morang Cotton Mill (1941), Morang Sugar Factory ( 1946), Raghupati Jute Mill (1946) Juddha Match Factory ( 1946).
- After the establishment of democracy in 1950 (2007 BS), the pace of industrialization is found to be accelerated.
- After restoration of Democracy in 1990 (2046/2047 BS) and adoption of modern liberalization policy the pace of industrialization is found to be accelerated significantly.
- As per the data 2013/14 the total number of industries in Nepal reached to 5,931 with employment to 4,94,407 person.

### **2. Structure of Nepalese Industrial Sector:**

- a. Classification on the basis of nature of output
  - Agro and forest based industries
  - Manufacturing industries
  - Export oriented industries
  - Energy based industries
  - Mineral industries
  - Tourism industries
  - Construction industries

- Information and communication industries
  - Service industries
- b. Classification on the basis of size and investment:
- Micro-enterprises (fixed assets from 0.2 million to 2 millions)
  - Cottage industries
  - Small industries : fixed assets upto 50 millions
  - Medium industries : fixed assets more than 50 millions upto 150 millions
  - Large industries: more than 150 millions

### 3. Performance:

a. Capital investment: The amount of capital investment is one indicator of the performance of industries:

- Energy sector: 60.2%
- Production oriented sector :17.9%
- Service sector :8.6% (2013/14 data)

b. Employment Generation:

- Production oriented sector (278,062 person)
- Services sector: 102,305
- Tourism sector : 47,206

The total employment generated in 2013/14 is 14,501. Out of which tourism sector contribute highest 29.79%, production oriented 23.62% and service sector 22.40%.

c. Foreign Investment

- Total foreign investment reached 17,888.65 million in 2013/14.
- 3172 industries generating 201720 employments.
- services 32.28%
- Production oriented 28.50%
- Tourism 27.55% (2013/14)
- 305 industries obtain license in 2013/14 which is less by 3.78 % preceding year.

d. Capacity Utilization:

- Average capacity utilization by industries is 51.3%. (2013/14)
- Tea industries 93.4% (highest)

- Rice 13.4 % (lowest) (due to floods)
- Issuance so industrial loan increased by 12.4%
- e. Contribution to GDP:
  - Contribution is decreasing
  - 16.08 % in 2006/007
  - 14.46% in 2013/14 (lack of investment climate ,political condition and energy crisis)
- f. Growth rate:
  - Average growth rate from 2005/06 to 2013/14 is 3.29%.
  - Growth rate of 2013/14 is 6.19%

#### **4. Problems of Industrial Sector in Nepal**

- a. Political instability
- b. Government policy and regulation
- c. Lack of energy
- d. Lack of security
- e. Quality of product
- f. Weak technology
- g. Low capacity utilization
- h. Lack of physical infrastructure
- i. Labour regulation and labour unions

#### **Natural Environment in Nepal**

- Nepal is rich in natural resources.
- It is a source of food supply, energy, medicine and input of industries.

#### **Components of Natural resources:**

- a. Forest
- b. Water
- c. Minerals

#### **a. Forest: Total land occupied by forest in Nepal:**

- 37.7% in 1990
- 27.2% in 2000
- 25.4% in 2010
- Continuous decrease in forest seriously threatened the Natural Environment.
- Source of paper, timber, furniture, medicinal herbs.



- Habitat of many kind of wild birds and animals.
- Support agriculture as it causes rainfall.
- Around 19% of forest in Nepal is covered by **National parks, Wild life Reserves, Conservation Area, Hunting area, and Buffer Zones.**

**b. Water:**

- Nepal is one of the richest country in the water resources.
- The total length of approx. 600 rivers in Nepal is estimated to be 45000 km.
- High prospects of Hydroelectricity.
- Theoretically 83000MW, Practically 40000MW
- Total electricity generation 782.45MW at the ending periods of eight months of 2014/2015.

**c. Minerals:**

- Iron, copper, mica, limestone, lead, coal, magnisite, natural gas found in Nepal
- 1% contribution to GDP

**Area where minerals were found:**

- Iron ore: Fulchoki, Labdikhola, Jirwant, Those
- Copper: Bhotekhola, Gyaji, Arkhaule
- Mica: Bajhang, Chainpur, Doti, Bhojpur, Nuwakot
- Lime stone: Chovar, Jogimara, Bhaise, Rasuwa
- Lead: Durlang, Baglung, Rasuwa
- Coal: Dang, Salyan, Kathmandu, Chitwan
- Gold: Narayani river

**Energy Situation in Nepal**

- Energy is required for economic and social development. Development of trade and industry largely depends upon the energy.
- Despite high potential for generating energy through abundant water resource, energy crisis has continued to grow.
- 72.60% of total energy generated in Nepal is by firewood source. 14% increased in 2013/14 alone. This possesses threat to forest of Nepal.
- 2.59 % of total energy consumption is generated by renewable energy sources. The use of renewable energy is drastically increased by 75.3% in 2013/14.

a. **Electricity:**

- Out of total capacity, Less than 2% of electricity is produced.
- Number of customer increased 4.4%
- Number of line distribution increased 1.7%
- Demand of electricity increased by 9.8% in 2013/14.

b. **Petroleum Products:** ( petrol, diesel, kerosene, Aviation turbine fuel, LP gas, Furnace Oil)

- 11.25 % of the total energy consumption is provided by petroleum products.
- 6.9% increased than previous year.
- Full depend on India.
- Now agreement with China for petroleum products.
- Total consumption in first eight month of 2014/15: 1,305,601 KL

**Emerging Business Environment in Nepal**

- a. Increased Private investment
- b. Growing Urban Population: 13.4% in 2000, reached to 18.2% in 2010 and increasing.
- c. Rising informed and educated customers
- d. Changing role of government
- e. Rising economic agendas
- f. Use of modern technologies
- g. Integration to the world economy
- h. Shifting social cultures
- i. Shift towards service industry
- j. Work force diversity