MACROECONOMIC UPDATE

NEPAL

VOLUME. 7, NO.1

April 2019

ASIAN DEVELOPMENT BANK

MACROECONOMIC UPDATE

NEPAL

VOLUME. 7, NO. 1

April 2019

ASIAN DEVELOPMENT BANK

This issue of the Nepal Resident Mission (NRM) Macroeconomic Update was prepared by the following team with overall guidance from Mukhtor Khamudkhanov, Country Director, NRM and Sharad Bhandari, Principal Economist, NRM. Lei Lei Song, Regional Economic Advisor, South Asia Department (SARD); Tadateru Hayashi, Principal Economist, Regional Cooperation and Operations Coordination Division (SARC); Masato Nakane, Senior Economist, SARC; and Anjan Panday, Senior Programs Officer, NRM reviewed the draft and provided comments and suggestions.

Manbar Singh Khadka, Economics Officer, NRM.
Neelina Nakarmi, Economics Analyst, NRM.

Supported by:
Malika KC (Thapa), Operations Assistant, NRM

Asian Development Bank
Nepal Resident Mission
Metro Park Building, Lazimpat
Post Box 5017
Kathmandu, Nepal
Tel +977 1 4005120
Fax +977 1 4005137
adbnrm@adb.org
www.adb.org/nepal
www.facebook.com/adbnrm/

CONTENTS

ABBREVIATIONS

BFI = banks and financial institutions
BPO = business process outsourcing
FDI = foreign direct investment
GATS = General Agreement on Trade in Services
GDP = gross domestic product
ICT = Information and Communication Technology
IRC = interest rate corridor
IT = information technology
NEPSE = Nepal Stock Exchange
NRB = Nepal Rastra Bank
NTIS = Nepal Trade Integration Strategy
SNG = sub-national government
WTO = World Trade Organization
y-o-y = year-on-year

NOTE

i. The fiscal year (FY) of the government ends in mid-July. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2018 ended on 16 July 2018.
ii. In this report, "$" refers to US dollars.

Executive Summary

1. **The economy is anticipated to grow by 6.2% in fiscal year (FY)2019, marginally down from 6.3% in FY2018.** Normal monsoon is expected to boost paddy production to 5.5 million tons, a rise of 8.4% from a year earlier. Production of maize, the other important summer crop, is also projected to rise by 1.8%. Industry will likely grow by 7.1% in FY2019 buoyed by increased availability of electricity and conducive socio-political environment. Enactment of Foreign Investment and Technology Transfer Act 2019, Public-Private Partnership and Investment Act 2019 and amendment to Special Economic Zone Act 2016 will likely boost business confidence, supporting the growth of foreign investment across industries. Construction has gained momentum in the fiscal year through mid-February 2019 and will probably rise given the development needs in, and larger budget allocation to, sub-national governments (SNGs) and the accelerated post-earthquake reconstruction. Services growth will edge up to 6.4%, supported by expansion of wholesale and retail trade, hotel and restaurant, and financial intermediation.

2. **On the demand side, growth in public infrastructure spending and private investment as well as buoyant government expenses will drive growth in FY2019.** Data to mid-February 2019 show that capital expenditure increased by 6.7% over the year-earlier period. The spending of SNGs will also stimulate growth in FY2019. Private consumption will likely remain strong on the back of robust growth of remittance despite a fall in out-migration and the gradual appreciation of Nepali rupee vis-à-vis the US dollar.

3. **Gross domestic product (GDP) growth at 6.3% is envisaged for FY2020, assuming a normal monsoon and no untoward circumstances such as floods devastating crop production.** The ongoing mechanization of agriculture, efforts to accelerate the implementation of large infrastructure projects, and the likely implementation of proposed legal reforms to promote investment will support growth.

4. **Average annual inflation will edge up to 4.4% in FY2019 from 4.2% in FY2018.** Inflation averaged 4.2% in the first 7 months of FY2019, above the 3.7% result in the year-earlier period. The increase in crop production, ease in the supply of goods, availability of electricity, subdued oil prices and expectation of a modest rise of inflation in India will quell inflationary pressure in FY2019. Average annual inflation will stay moderate at 5.1% in FY2020, assuming a better harvest, stable oil prices and a modest rise of inflation in India.

5. **Data to mid-February 2019 show that trade deficit has surpassed the net invisible earnings, widening the current account deficit to $1.5 billion, slightly up from a deficit of $1.4 billion in the year earlier period.** The rising current account deficit and weak financial inflows led to an overall balance of payment deficit of $433.0 million in mid-February 2019 higher than the deficit of $179.1 million in the year earlier period. The current account deficit is projected to widen further to 9.3% of GDP, up from 8.2% a year earlier because of increasing imports of capital and consumer goods and services irrespective of a healthy growth of remittance and modest oil prices. The current account deficit is expected to narrow down to 8.1% of GDP in FY2020 as import growth restrains following measures taken to curtail the import of non-priority items and an increased generation of hydroelectricity, partly offsetting the consumption of fossil fuel. Remittances will continue to grow healthily though falling substantially behind trade deficit expansion.

6. **Downside risks to outlook in FY2020 center on challenges to smooth implementation of fiscal federalism.** While some key legislations have been enacted and the National Natural Resources and Fiscal Commission constituted, the SNGs face challenges in terms of program and project development, project implementation, grant utilization and maintaining fiscal discipline at large. Further, the recent buildup of credit to construction, overdraft and working capital in the absence of strong risk management practices may induce financial sector vulnerabilities.

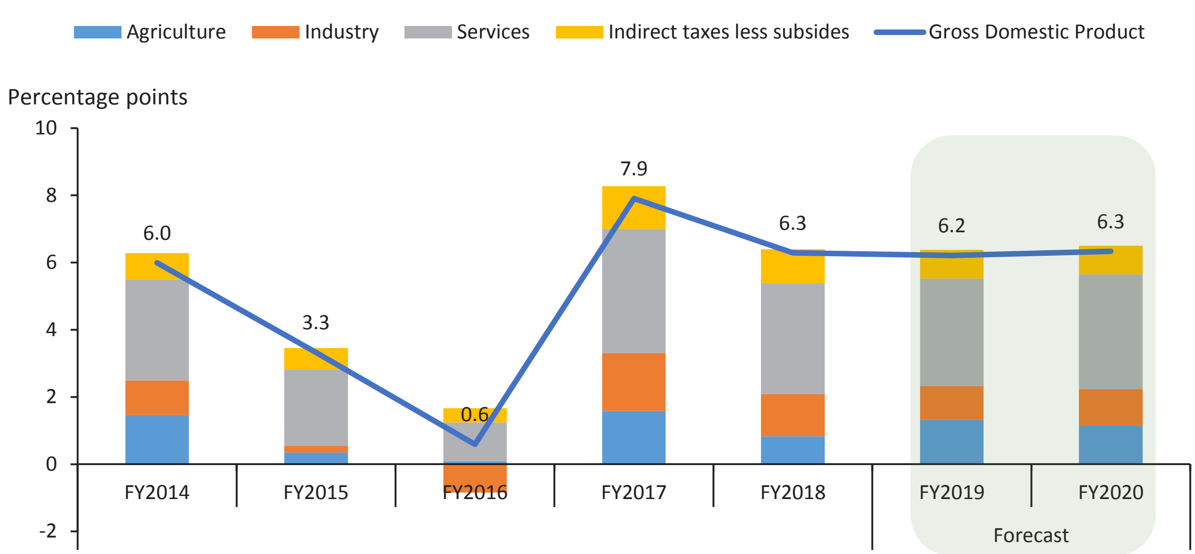
7. **This edition of Macroeconomic Update's Issue Focus sheds light on the current state and prospects of Nepal's services trade and suggests sector-specific policy recommendations.** Landlocked-ness and mountainous terrain have historically impeded the promotion of merchandise trade in Nepal. Lack of competitiveness has further held back merchandise exports. Consequently, Nepal's merchandise trade deficit as a share of GDP has substantially ballooned over the years. Growth in services export, on the other hand, has been better than the growth in merchandise export. The services sector accounted for 66.0% of total exports and 13.0% of total imports in FY2018, indicating its growing importance in external trade. But because of infrastructural, institutional, legal and procedural barriers, the services trade in Nepal has yet to achieve its full potential.

MACROECONOMIC UPDATE

A. Economic performance in FY2018

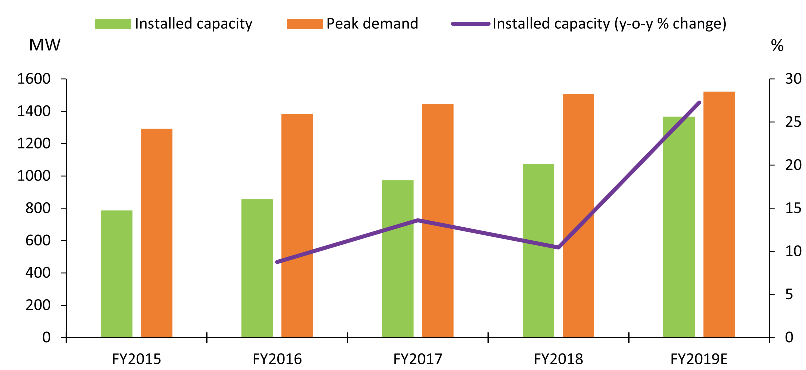
1. Gross domestic product (GDP) growth edged down to an estimated 6.3% in fiscal year 2018 (FY2018, ended 16 July 2018) from 7.9% in fiscal year 2017 that accelerated from a low base (Figure 1). Floods of August 2017 crimped paddy production by 1.5% compared to the previous year. Manufacturing grew by 8.0%, though down from 9.7% a year earlier, on increased availability of electricity. Construction grew at a sustained pace with the sub-sector taking off at sub-national levels and the renewed acceleration of post-earthquake reconstruction. Several small sized hydropower projects commenced operation, raising the installed electricity capacity by 10.5% in FY2018 (Figure 2). Tourists' arrival (Figure 3) increased favoring the expansion of hotels and restaurants and travel and communication services as the economy recovered from the 2015 earthquakes and the September 2015 – February 2016 trade and supply disruptions, further bolstered by the prospects of a more stable socio-political environment.

Figure 1: Supply-side contributions to growth



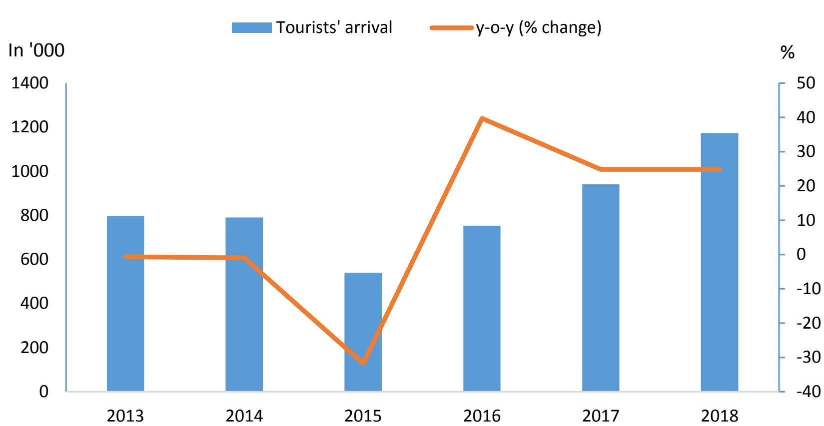
Source: Central Bureau of Statistics; ADB estimates.

Figure 2: Electricity demand and supply (MW)



MW = megawatt
Source: Nepal Electricity Authority

Figure 3: Tourists' arrival

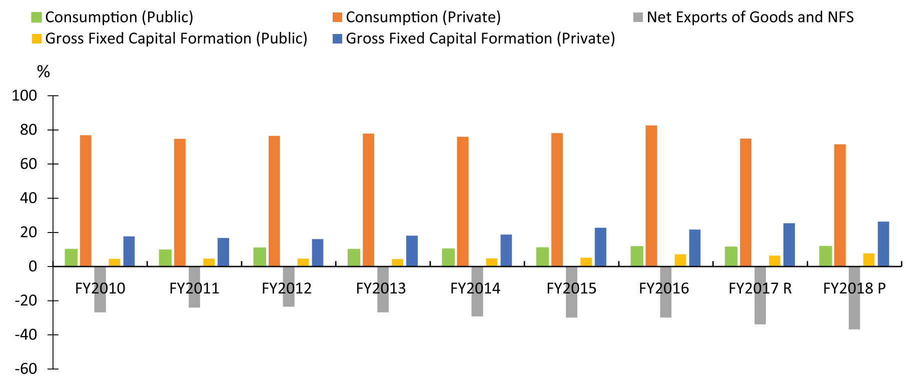


Source: Department of Tourism and Department of Immigration

2. On the demand side, high consumption, induced by remittance, dominated spending in FY2018. Fixed investment rose by 15.7%, on higher private investment in manufacturing, energy and tourism, to account for nearly one-third of GDP. A strong growth in the construction led to an increased import of input materials as well as capital goods, widening trade deficit in FY2018 (Figure 4).

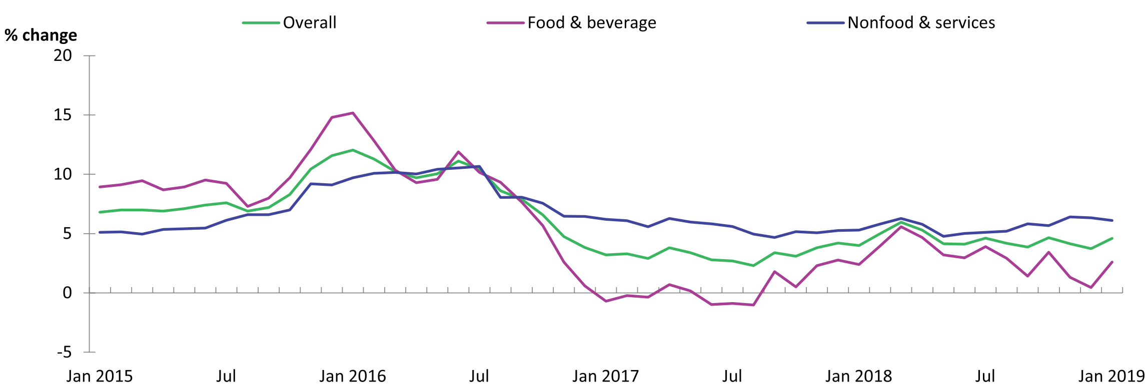
3. Inflation inched down to 4.2% in FY2018 from 4.5% a year earlier, mainly on the back of subdued inflation in neighboring India, the main source of supplies, and to whose currency the Nepali rupee is pegged (Figure 5). Despite a spike in domestic oil prices, the ease in the supply of goods, and slow rise in prices for health care and education services tamed overall inflation.

Figure 4: Share of GDP by expenditure



R = revised; P = provisional
Source: Central Bureau of Statistics

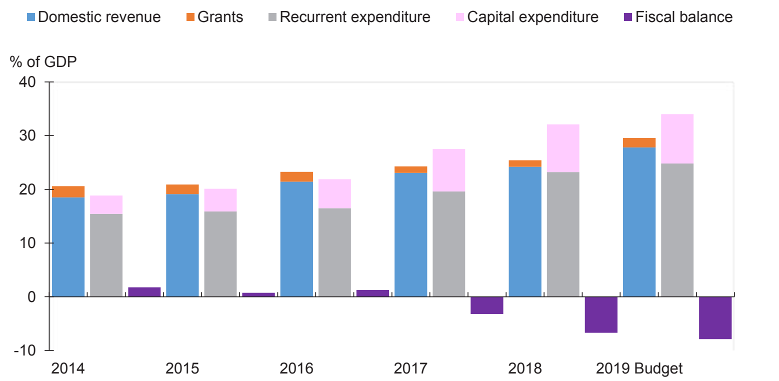
Figure 5: Monthly inflation



Source: Nepal Rastra Bank.

4. With higher recurrent and capital expenditures, budget deficit widened to 6.7% of GDP in FY2018, up from 3.2% a year earlier (Figure 6). Budget implementation reforms and the government's push toward execution in the last months of the fiscal year accelerated capital expenditures by 28.0%. The election expenses and the fiscal transfer of about 8.0% of GDP to sub-national governments (SNGs) also boosted recurrent expenditures. Nonetheless, long-standing challenges tied to project readiness, procurement processes, and project management have often hampered smooth implementation, affecting budget execution and limiting public investment. Revenue collection increased by 20.1% to equal 24.3% of GDP in FY2018 on higher import growth. To meet higher financing requirements, the government raised external debt by 26.6% to equal 17.4% of GDP in FY2018.

Figure 6: Fiscal indicators



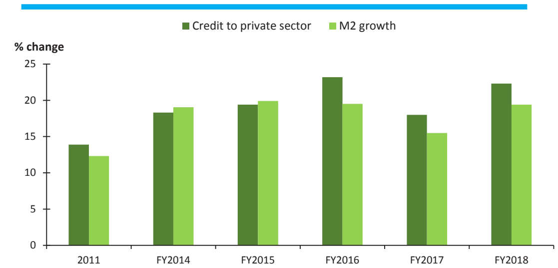
Source: Ministry of Finance. Budget Speech various years.

5. Broad money (M2) supply increased by 19.4% in FY2018, up from an increase of 15.5% a year earlier on rising net domestic assets (Figure 7). Credit to the private sector grew by 22.3% with a significant share going to wholesale and retail trade, production and construction.

6. While the Nepali rupee depreciated against the US dollar in nominal terms, the currency has been appreciating in real effective terms.[1] Nominal depreciation was by 6.0% in the fiscal year to mid-July 2018, in line with the depreciation of Indian rupee. The Nepali rupee has appreciated in real effective terms with rising demand of non-tradable vis-à-vis tradable sector, leading to higher inflation and thus dampening export competitiveness.

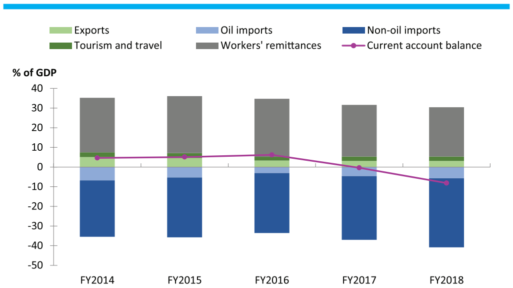
7. Merchandise trade deficit widened on higher import growth and weak export competitiveness. Imports particularly of construction materials and capital goods surged in FY2018 flaring trade deficit to $10.9 billion equivalent to 37.7% of GDP rising from 33.9% in FY2017. Despite remittance growing healthily at 10.5% in FY2018, the current account deficit widened to $2.3 billion, or 8.2% of GDP, up from the deficit of $95.4 million in FY2017 (Figure 8). Nonetheless, financial inflows boosted gross foreign exchange reserves to $10.1 billion, providing 9.4 months of cover for imports of goods and services (Figure 9).

Figure 7: Credit to the private sector and M2 growth



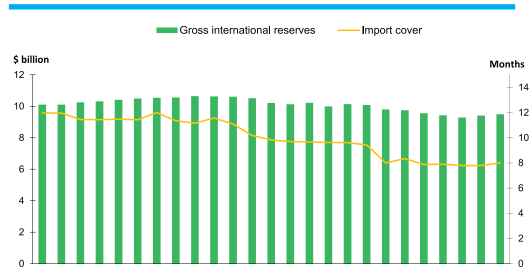
Source: Nepal Rastra Bank.

Figure 8: Current account indicators



Source: Nepal Rastra Bank.

Figure 9: Gross international reserves and foreign exchange adequacy



Source: Nepal Rastra Bank.

[1] As per the IMF's recent macroeconomic developments released in February 2019, the real effective exchange rate remained about 11% above the 2010-2014 average.

B. Economic prospects in FY2019 and FY2020

8. The economy is anticipated to grow by 6.2% in FY2019, marginally down from 6.3% in FY2018 (Figure 1; Table 1). Normal monsoon is expected to boost paddy production to 5.5 million tons, a rise of 8.4% from a year earlier. Production of maize, the other important summer crop, is also projected to rise by 1.8% (Figure 10). Further, the winter rainfall has been timely that will likely boost the production of cash crops like potatoes, vegetables and fruits, boosting the overall agriculture growth by 4.5%.

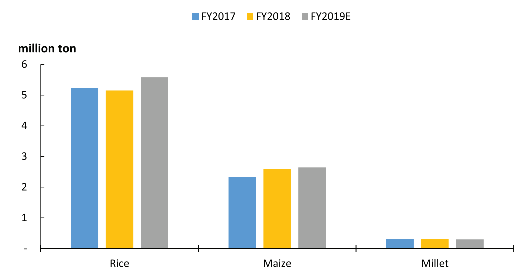
9. Industry will likely grow by 7.1% in FY2019 buoyed by increased availability of electricity and conducive socio-political environment.[2] With no major power-cuts since May 2018, more manufacturing firms have not only come into operation but also the capacity utilization of existing industries has improved (Figure 11). Enactment of Foreign Investment and Technology Transfer Act 2019, Public-Private Partnership and Investment Act 2019 and amendment to Special Economic Zone Act 2016 will likely boost business confidence, supporting the growth of foreign investment across industries. Construction has gained momentum in the fiscal year through mid-January 2019 and will probably rise given the development needs in, and larger budget allocation to, SNGs and the accelerated post-earthquake reconstruction (Table 2). With notable progress in the construction of Gautam Buddha International Airport, the government is committed to completing this airport by 2019. Services growth will edge up to 6.4%, supported by expansion of wholesale and retail trade, hotel and restaurant, and financial intermediation.[3] Data to mid-February 2019 show about 31.0% year-on-year (y-o-y) growth in the registration of services' industries.[4]

Table 1: Selected economic indicators (%)

	2019	2020
GDP growth	6.2	6.3
Inflation	4.4	5.1
Current account balance (share of GDP)	-9.3	-8.1

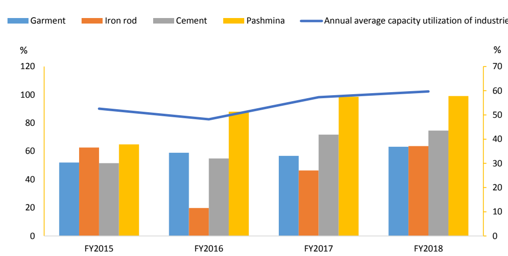
Source: ADB estimates

Figure 10: Major crops production



E = estimate
Source: Ministry of Agriculture and Livestock Development

Figure 11: Capacity utilization of major industries



Source: Nepal Rastra Bank

2 Labor-management relations may have improved evident with the absence of strikes and protests across industries that used to be quite often in the past. The formation of a stable government and enactment of key legislations such as Labor Act 2017 and Social Security Act 2017 may have helped improve the environment.

3 Commercial banks as of mid-February 2019 have begun their operations through branch offices established in 711 out of 753 local levels. The remaining 42 local levels will probably have commercial banks' branch offices by end of FY2019.

4 Department of Industry, Ministry of Industry, Commerce and Supplies, Government of Nepal.

Table 2: Reconstruction status of private houses and public infrastructure

	23 August 2018			25 March 2019		
Status	Targeted	Completed	Under construction	Targeted	Completed	Under construction
Private housing	807486	270824	541746	812371	372560	601674
Archaeological heritages	753	185	309	753	212	224
Educational institutions	7553	3816	2369	7553	4172	2506

Note: the targeted households refer to eligible households for private housing grants.
Source: National Reconstruction Authority

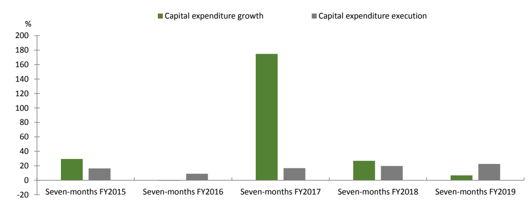
10. Growth in public infrastructure spending and private investment as well as buoyant government expenses will drive growth in FY2019. Data to mid-February 2019 show that capital expenditure increased by 6.7% over the year-earlier period (Figure 12). The spending of SNGs will also stimulate growth in FY2019.

11. Revenue collection increased by 2.0% y-o-y in the first seven months of FY2019 after rising by 20.0% a year earlier (Figure 13). The revenue collection has primarily increased on higher import growth and an improvement of the tax system.[5] Reforms to custom valuation and adoption of risk-based customs clearance and e-payment system have helped control revenue leakages.[6] Data to mid-February 2019 show that value added tax, income tax and custom duties are the largest contributors to revenue generation with their shares standing at 29.5%, 21.3% and 20.0%, respectively.[7]

12. The budget as of mid-January 2019 is in surplus by NRs 173.3 billion, up from a surplus of NRs 20.0 billion in the corresponding period of FY2018. Strong revenue growth and a marginal slowdown in recurrent expenses led to budget surplus in the review period. The FY2019 budget envisages a deficit of about 8.0% of GDP, but it will likely be lower as capital expenditure continues to underperform allocation with mere 22.5% executed in the first seven months of FY2019.[8]

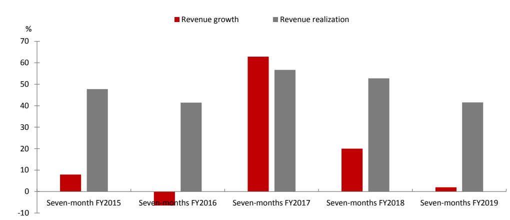
13. The external debt rose to NRs 561.7 billion (16.4% of GDP) in mid-FY2019, up from NRs 436.5 billion a year earlier period. The internal debt decreased to NRs 385.7 billion (11.3% of GDP) in mid-FY2019 from NRs 394.5 billion, reflecting the early improved fiscal balance. The total public debt however rose by about 3.5% in the first 6 months to fiscal year 2019. Nonetheless, Nepal faces low debt distress given the high level of official concessional borrowing at longer maturity.[9]

Figure 12: Capital expenditure growth and execution



Source: Ministry of Finance, Budget speech various years; Financial Comptroller General Office.

Figure 13: Revenue growth and realization



Source: NRB; Ministry of Finance, Budget speech various years.

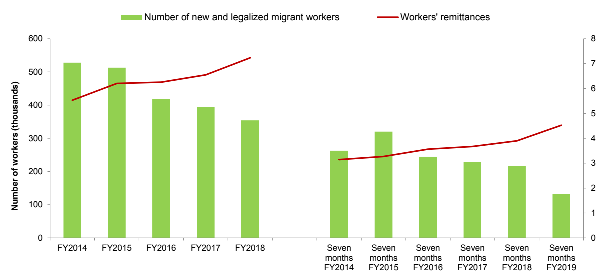
[5] The Ministry of Finance has revoked the provision of direct refund of VAT to registered taxpayers. Excise duties have been increased on alcohol, cigarette and tobacco-based goods. A progressive tax reform was introduced by changing the existing individual income tax slabs of 15% and 25% to 10%, 20% and 30%. For details, see Budget Speech 2019.
[6] Through the ongoing Customs Reform and Modernization for Trade Facilitation Program, the Department of Customs is implementing ASYCUDA World and risk-based custom clearance to incentivize traders with good track record with faster compliance.
[7] Nepal Rastra Bank (NRB). Current Macroeconomic and Financial Situation of Nepal Based on seven months' data for FY2019.
[8] Some disbursement in second half might be for actual work done in the first half of the fiscal year.
[9] International Monetary Fund. 2019. Nepal – Staff Report for the 2018 Article IV Consultation. Washington D.C.

14. Private consumption will likely remain strong on the back of robust growth of remittance despite a fall in out-migration (Figure 14) and the gradual appreciation of Nepali rupee vis-à-vis the US dollar.[10] Trade deficit will further widen in FY2019 with rising imports of oil and non-oil products, reflecting domestic demand, and as the economy continues to suffer from low manufacturing base and weak export competitiveness. Data to mid-February 2019 show that trade deficit has surpassed the net invisible earnings, widening the current account deficit to $1.5 billion, slightly up from a deficit of $1.4 billion in the year earlier period. The rising current account deficit and weak financial inflows led to an overall balance of payment deficit of $433.0 million in mid-February 2019 higher than the deficit of $179.1 million in the year earlier period (Figure 15). The current account deficit is projected to widen further to 9.3% of GDP, up from 8.2% a year earlier because of increasing imports of capital and consumer goods and services irrespective of a healthy growth of remittance and modest oil prices (Table 1).

15. Average annual inflation will edge up to 4.4% in FY2019 from 4.2% in FY2018 (see Table 1). Inflation averaged 4.2% in the first 7 months of FY2019, above the 3.7% result in the year-earlier period. The increase in crop production, ease in the supply of goods, availability of electricity, subdued oil prices and expectation of a modest rise of inflation in India will quell inflationary pressure in FY2019.

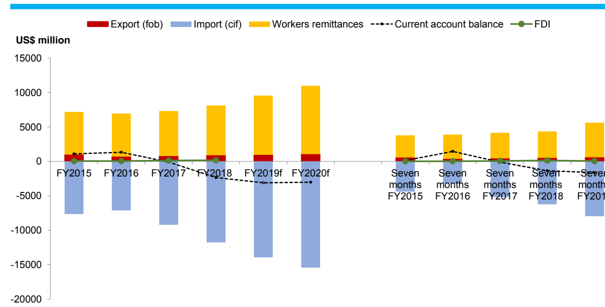
16. Monetary Policy for FY2019 aims to contain inflation by maintaining growth in broad money (M2) supply at 18.0% while prioritizing interest rate stability. M2 expanded by 19.2% y-o-y in the fiscal year through mid-February 2019 mainly on higher credit growth to the private sector (Figure 16). Both deposit collection and credit disbursement of banks and financial institutions (BFIs) increased in the fiscal year through mid-February 2019. Deposit collection increased by 21.3% y-o-y in mid-February 2019 mainly on higher growth of remittance and a falling Nepal Stock Exchange (NEPSE) index[11] (Figure 17). Credit disbursement increased by 22.4% y-o-y in mid-February 2019, up from 19.6% a year earlier (Figure 18), reflecting a strong credit demand in construction, production and service related industries.

Figure 14: Number of migrants and remittance inflows



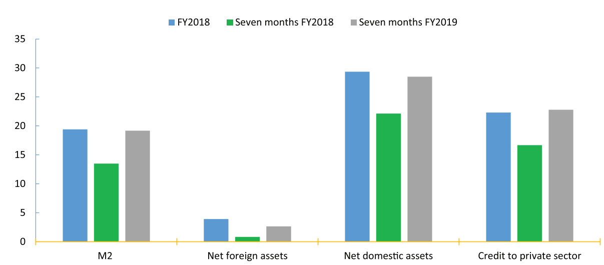
Source: Department of Foreign Employment; Nepal Rastra Bank.

Figure 15: External sector



Source: Nepal Rastra Bank.

Figure 16: Monetary sector (y-o-y % change)



Source: Nepal Rastra Bank

[10] Migration for overseas employment dropped by about 40% year-on-year in mid-February 2019 mainly due to lower demand in major destination countries like Qatar and Saudi Arabia and the deadlock in sending migrant workers to Malaysia.

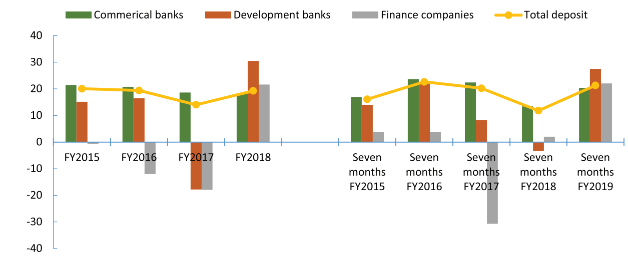
[11] The Nepal Stock Exchange (NEPSE) index decreased by 17.7% y-o-y to 1178.0 points in mid-January 2019. Diminishing public interest in the purchase of shares could be due to multiple reasons apart from lack of confidence in the economy. First, the provision of margin lending by BFIs against the collateral of shares has been reduced from 50% of their core capital to 40%. Second, banks, in a bid to attract deposits, have increased interest rates on deposit schemes, particularly fixed deposits, making deposits more attractive than investment on shares. Third, very few companies are listed in the secondary market. And fourth, the recently introduced automated online share transactions has not been effective.

17. To address credit shortage, the Nepal Rastra Bank (NRB) had lowered cash reserve ratio (CRR) in FY2019.[12] This change helped inject an additional liquidity equivalent to 1.4% of GDP into the economy. Data to mid-February 2019 show that credit to production increased by 18.0% in the first 7 months of FY2019 higher than the rise of 11.3% in the corresponding period a year earlier. Likewise, credit to construction grew by 15.2% in the first 7 months of FY2019 higher than the rise of 12.2% in the corresponding period a year earlier. Of the total sector wise credit, wholesale and retail trade, production and construction constituted the biggest share at 21.4%, 17.0% and 10.5%, respectively in the first 7 months of FY2019. Credit growth to real estate, hire purchase, overdraft and margin lending has however moderated in the first 7 months of FY2019, thanks to strict enforcement of credit to core capital plus deposit (CCD) ratio at 80.0% and capping lending ratio to real estate sector at 25% of their total credit.[13] Consequently, the real estate loan grew by 1.8% in the first seven months of FY2019 after rising by 6.7% in the corresponding period a year earlier. Similarly, hire purchase credit increased by 7.5% in the first seven months of FY2019 after rising by 8.4% in the corresponding period a year earlier.

18. In a bid to support credit-led growth, the excess liquidity from the market has not been mopped up at 3.5% (floor rate) under an interest rate corridor (IRC)[14] mechanism in FY2019, leading to substantial interbank interest rate volatility (Figure 19). The weighted average deposit and lending rates of commercial banks are gradually stabilizing with the interest rate spread moderating toward 5.0%, albeit still higher than the mandated spread of 4.5% by mid-July 2019 (Figure 20).

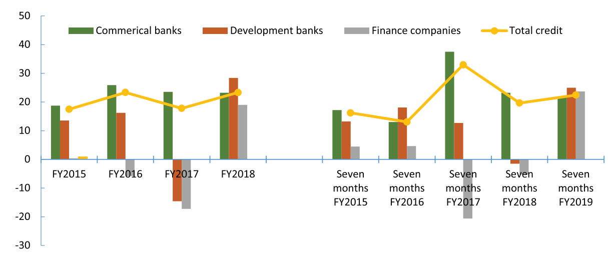
19. GDP growth at 6.3% is envisaged for FY2020, assuming a normal monsoon and no untoward circumstances such as floods devastating crop production. The ongoing mechanization of agriculture, efforts to accelerate the implementation of large infrastructure projects, and the likely implementation of proposed legal reforms to promote investment will support growth.[15]

Figure 17: Growth in deposit collection (y-o-y % change)



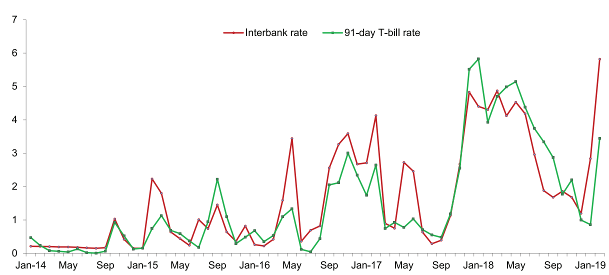
Source: Nepal Rastra Bank

Figure 18: Credit growth of BFIs (y-o-y % change)



Source: Nepal Rastra Bank

Figure 19: Weighted average inter bank rates (%)



Source: Nepal Rastra Bank

12 The cash reserve ratio (CRR) for commercial banks, development banks and finance companies have been fixed at 4%. Such rates were 6% for commercial banks, 5% for development banks and 4% for finance companies.

13 The Monetary Policy for FY2018 reduced loan-to-value (LTV) ratio in real estate sector within Kathmandu valley from 50% to 40%, while the ratio outside Kathmandu valley was kept unchanged at 50%. NRB has directed BFIs not to finance more than 50% of the value on auto purchase for personal use. Previously, the BFIs could finance up to 65% of the value on auto purchase for personal use. The provision of personal credit such as overdraft from BFIs has been reduced from NRs 7.5 million to NRs 5 million. For details, see review of Monetary Policy 2019.

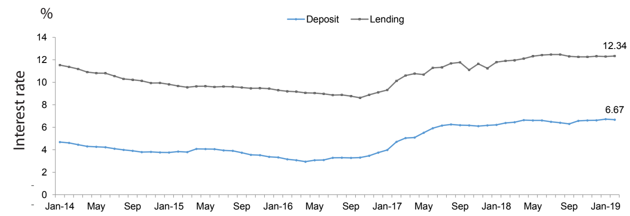
14 To address short-term interest rate volatility, the Central Bank (NRB) introduced interest rate coridor (IRC) since FY2017. The upper and lower limits of the IRC were fixed at 6.5% and 3.5%, respectively, narrowing down the IRC width, and the interbank rates were expected to hover around policy rate of 5%.

15 While Foreign Investment and Technology Transfer Act, Public Private Partnership and Investment Act along with amendments to Special Economic Zone Act have been passed, other legislations in work such as Safeguards, Anti-countervailing related Act, Company Act, Industrial Enterprise Act, Public Procurement Act, Foreign Exchange Act, and Intellectual Property Protection Act, among others are expected to be passed in the next session of the Parliament.

Average annual inflation will stay moderate at 5.1% in FY2020, assuming a better harvest, stable oil prices and a modest rise of inflation in India. The current account deficit is expected to narrow down to 8.1% of GDP as import growth restrains with the measures[16] taken to curtail the import of non-priority items and an increased generation of hydroelectricity (see Table 1), partly offsetting the consumption of fossil fuel.[17] Remittances will continue to grow healthily though falling substantially behind trade deficit expansion.

20. Downside risks to outlook in FY2020 center on challenges to smooth implementation of fiscal federalism. While some key legislations have been enacted and the National Natural Resources and Fiscal Commission constituted, the SNGs face challenges in terms of program and project development, project implementation, grant utilization and maintaining fiscal discipline at large. Further, the recent buildup of credit to construction, overdraft and working capital in the absence of strong risk management practices may induce financial sector vulnerabilities.

Figure 20: Weighted average rates (commercial banks)



Source: Nepal Rastra Bank

[16] The budget speech for FY2019 increased excise duties on four-wheeler vehicles above 1,000cc and motorcycle above 150cc.
[17] Upper Tamakoshi of 456 MW is expected to be completed in FY2020.

ISSUE FOCUS
Prospects of trade in services in Nepal*

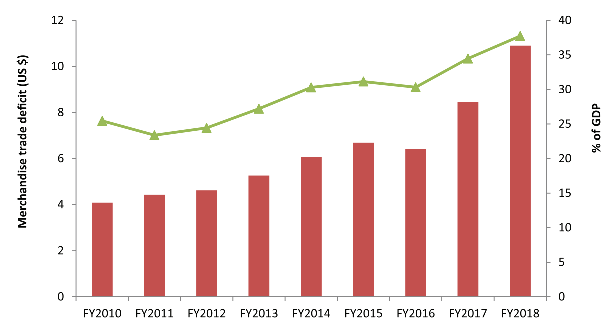
A. Introduction and objective

1. Landlocked-ness and mountainous terrain have historically impeded the promotion of merchandise trade in Nepal. Lack of competitiveness, in par with international goods, emanating from structural bottlenecks and policy inconsistencies has further held back merchandise exports. Consequently, Nepal's merchandise trade deficit as a share of gross domestic product (GDP) has substantially ballooned over the years (Figure 1).

2. Growth in services exports, on the other hand, has been better than the growth in merchandise exports (Figure 2). Services exports have averaged 13.1% annual growth during 2008-2017, surpassing the growth of neighboring countries, Bangladesh and India but falling short of Sri Lanka (Figure 3). Services income, particularly from travel and tourism and communication has increased, signaling a shift from agro-based to service-oriented economy. But because of infrastructural, institutional, legal and procedural barriers, trade in services[1] in Nepal has yet to achieve its full potential.

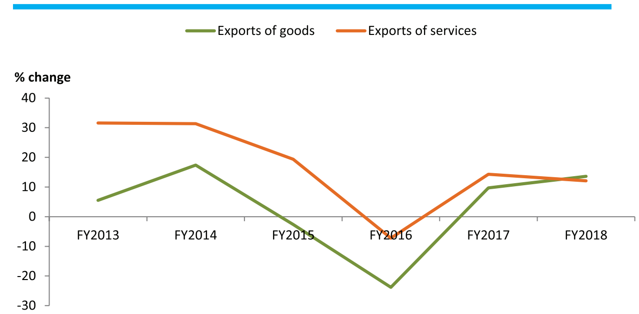
3. Landlocked and least developed countries like Nepal can bridge their trade deficit via export diversification in services sector.[2] The services sector accounted for 66% of total exports and 13% of total imports in FY2018, indicating its growing importance in external trade (Figure 4). This Issue Focus sheds light on the current state and prospects of Nepal's services trade and suggests sector-specific policy recommendations.

Figure 1: Merchandise trade deficit



Source: Nepal Rastra Bank

Figure 2: Growth in exports of goods and services



Source: Nepal Rastra Bank

B. Shift towards services sector

4. The structural transformation in Nepal is atypical as Nepal seems to have skipped the industrialization phase as observed in many developing economies. The shift is from agriculture to services

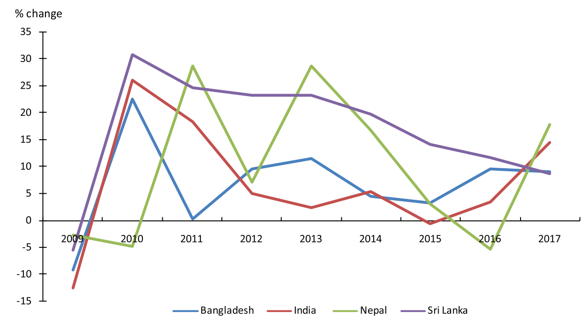
* This section was written by Manbar S. Khadka of Nepal Resident Mission, ADB and Rudra Suwal, former Deputy Director General of Central Bureau of Statistics (CBS).
1 It refers to services that can be traded across economies.
2 Geographical location is not a barrier to trade in services.

sector. In FY1999, the agriculture sector contributed 38.0% of GDP, industry and services sectors contributed 23.0% and 39.0% to GDP, respectively. But in FY2009, the contribution of agriculture, industry and services sectors to GDP were 36%, 16% and 48%, respectively. In FY2018, the sectoral shares of GDP of agriculture, industry and services sectors were 28.2%, 14.2% and 57.6%, respectively (Figure 5). What is evident from these statistics is that while agriculture and industrial sectors are languishing, the services sector is gaining momentum. In fact, the contribution of services sector to GDP had been steadily rising since the early 2000s. Despite the services sector's growing share of GDP, the sector has not been able to create commensurate employment opportunities[3] as most of the growth is likely in less productive informal activities (Bhatta, 2014). As such, agriculture continues to provide livelihood opportunities to two-thirds of the total population, largely at a subsistence-level.

5. Various hypotheses have been put forth to explain the structural shift observed across industrialized economies. For instance, Fischer-Clark hypothesis argues that with income growth, consumption pattern changes from goods to services, prompting a growth in services sector (Fischer, 1935; Clark, 1940). On the other hand, Cost-Disease hypothesis argues that the jump from manufacturing to services sector is due to productivity gaps between the two sectors (Baumol et al., 1985). In the case of Nepal, recent empirical studies argue that the large remittance inflows could have led to 'premature deindustrialization' induced by spending effect and resource movement effect of the transfer (Uddin, 2015).

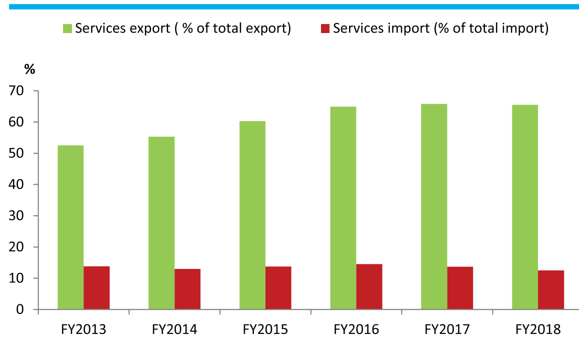
6. While services sector has boomed, there is also a growing inclination towards non-tradable versus tradable sector of the economy. Among service industries, wholesale and retail trade including real estate and renting businesses contribute significantly to the economy compared to transport, communications, financial intermediation and other related services (Table 1). This illustrates that non-tradable sub-sectors of the economy like real estate and renting business including wholesale and retail trade[4] are flourishing on the back of remittance income. This could well be the Dutch Disease[5] effect of migrant's remittances (Uddin, 2015; Taguchi & Lama, 2016).

Figure 3: Growth in exports of services



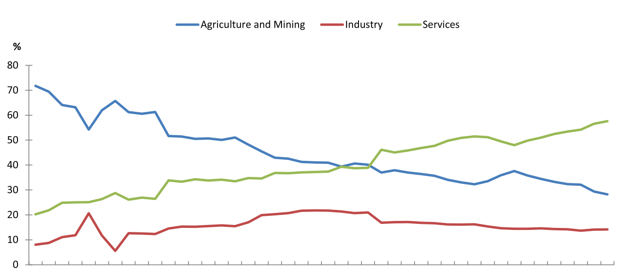
Source: World Bank, World Development Indicators (accessed 29 March 2019)

Figure 4: Share of services sector in external trade



Source: Nepal Rastra Bank; NRM staff estimates

Figure 5: Composition of gross value addition by major economic sectors



Source: Central Bureau of Statistics

---

3 Based on Annual Household Survey 2014/15, the employment shares of agriculture, industry and services are 69.4%, 11.8% and 18.8%, respectively.
4 It refers to growing outlets of wholesale and retail trade induced by remittance income and captures labor services embedded in wholesale and retail trade that are non-tradable.
5 Dutch Disease is said to occur when an economy experiences the shift of resources from tradable to non-tradable sector induced by large domestic spending effect, thereby appreciating real exchange rate and deteriorating export competitiveness

Table 1: Composition of Gross Value Added Among Service Industries (in %) (Selected fiscal years)

Industries	2001	2003	2005	2007	2009	2011	2013	2015	2017	2018	Direction, 2017-2018
Wholesale and retail trade	35.6	31.6	29.6	26.1	25.8	29.0	28.5	27.5	23.7	23.0	↓
Hotels and restaurants	4.3	3.5	3.3	2.8	2.9	3.4	3.7	3.8	3.5	3.6	↑
Transport, storage and communications	16.0	18.1	19.0	19.6	19.3	17.1	17.5	15.7	13.1	13.8	↑
Financial intermediation	5.8	5.9	6.4	8.0	8.1	8.1	7.7	8.7	9.9	11.0	↑
Real estate, renting and business activities	18.0	17.6	18.2	19.9	17.0	17.2	17.3	15.8	19.6	19.7	↑
Public administration and defense	2.7	3.7	3.5	3.4	3.9	4.0	4.0	4.9	5.2	5.0	↓
Education	8.9	11.3	11.7	11.5	13.0	10.9	11.4	12.3	12.7	12.4	↓
Health and social work	2.1	2.5	2.6	2.4	2.9	2.8	2.8	3.1	3.1	2.9	↓
Other community, social and personal service activities	6.6	5.7	5.6	6.1	7.1	7.6	7.2	8.2	9.1	8.5	↓
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	

Source: Central Bureau of Statistics; Computed from national accounts statistics

C. Nepal's readiness for services sector liberalization

7. Given the growing importance of services in international trade and the need for further liberalization, services were made an intrinsic part of the multilateral trade design of the World Trade Organization (WTO) in the form of General Agreement on Trade in Services (GATS) in January 1995. The scope of activities defined as services in this framework include: (i) business services; (ii) communication services; (iii) construction services; (iv) distribution services; (v) educational services; (vi) environmental services; (vii) financial services; (viii) health-related services; (ix) tourism and travel-related services; (x) recreational, cultural, and sporting services; (xi) transport services; (xii) other services not elsewhere included. (Cattaneo et al., 2010).

8. Nepal since acceding to WTO in 2004 has committed to liberalize 11 of the possible 12 services sub-sectors outlined under GATS.[6] As a member country of South Asia Association for Regional Cooperation (SAARC), Nepal is also a signatory to the SAARC Agreement on Trade in Services (SATIS) that was signed on 29 April 2010 with the objective to liberalize trade in services and further deepen the integration of regional economy. The four modes of trade in services as defined under GATS are:

(i) Mode 1: *Cross-border supply:* It refers to cross-border supply of services without the need for physical movement of consumers. An example would be distant learning or e-learning in education

[6] For details, see: Nepal's Preparedness for Services Sector Liberalization by Navin Dahal.

sector. Likewise, provision of health services in a country remotely from another country via the use of information and communication technologies (ICT), for example, consultations, tele-radiology, diagnosis.

(ii) Mode 2: *Consumption abroad:* It refers to movement of consumers across borders. Examples would be attending higher education abroad, getting medical treatment abroad, and going on a vacation abroad.

(iii) Mode 3: *Commercial presence:* It refers to establishing commercial facilities in another country to cater foreign demand. Examples would be establishing local branches, franchising arrangements with local institutions or capital movement to establish facilities on a joint venture basis.

(iv) Mode 4: *Movement of natural persons:* It refers to movement of people from one country to another to provide services on a temporary basis. An example would be visiting scholars and professors working abroad.

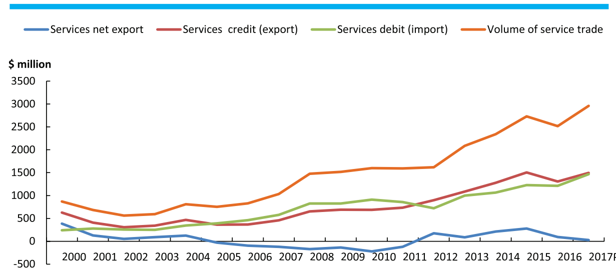
Source: Knight (2002) and Kelaher et al. (2011)

9. Interestingly, 3 of the 12 sectors identified in Nepal Trade Integration Strategy (NTIS 2016)[7] as potential export competitiveness are services-related. They are: a) tourism (leisure, business, education and medicals); b) labor services (semi-skilled and skilled human resources); and c) information technology (IT) and business process outsourcing (BPO) services. (Government of Nepal/Ministry of Commerce: NTIS, 2016).

D. Nepal's potential in trade in services

10. Nepal's foreign trade in services gained momentum with the adoption of economic liberalization and privatization in the early 1990s. Services trade balance has remained positive except for a period from 2006-2011.[8] Though positive, the net surplus from foreign trade in services has declined in recent years. (Figure 6). This is largely due to increased number of Nepalis going abroad for higher education, medical treatment, holidaying and other recreational activities. The major components of services trade are: travel, transport, insurance and finance, communication, government and other business services.

Figure 6: Trend of Nepal's export and import services trade



Source: Nepal Rastra Bank

[7] This is Nepal's national trade integration strategy document that identifies outstanding trade and competitiveness challenges and suggests actions to address constraints in several cross-cutting areas, such as, trade facilitation, institutional capacity development, standards and technical regulation and others.

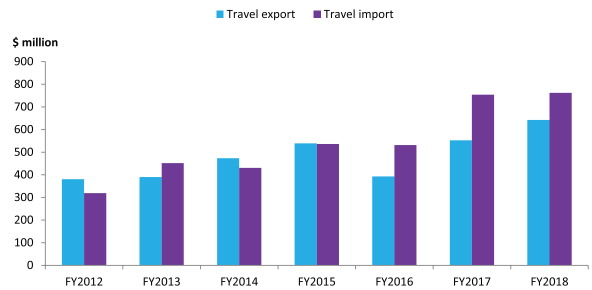
[8] Though services trade balance was in deficit, the volume of services trade increased during the period.

E. Travel and tourism related services

11. This is one of the services sub-sectors identified by NTIS (2016) with high export potential (see Box 1). Nepal is indeed blessed with scenic beauty ranging from high Himalayas to low-lying riverine lands. The varied climatic conditions and attractive destinations, be it from religious, cultural and/or geographical perspectives, can lure tourists from across the globe. In fact, Nepal has prominently featured as one of the top destination countries for tourism in Lonely Planet.[9] Yet, the average direct contribution of tourism to GDP has hovered at 3.9% from 2008-2018.[10]

12. While export of travel services has expanded in recent years, much needs to be done to further expand the sector and be a net exporter of travel services (Figure 7). Poor infrastructure is

Figure 7: Travel services trade



Source: Nepal Rastra Bank

Box 1: Importance of hospitality and tourism industry

Tourism industry has a distinctive place in Nepal's economy. The industry earns on an average 25% of the total foreign exchange and provides direct employment to more than 200,000 people.[13]

The sector was hard-hit by major earthquakes in 2015 and subsequent trade disruptions along the southern border. This resulted in a decline in the number of tourist flow in 2015 by 33%. However, the sector has revived since then with growing number of tourists. Adventure travelers for trekking and mountain biking and religious pilgrim are the major drivers of growth in tourism.

The government has set a target of attracting 2 million tourists by 2020, almost 100% increase compared to 2018, under "Visit Nepal 2020" Campaign. Domestic and foreign investment in hotel and restaurant sub-sector has increased. As per a senior official at the Ministry of Culture, Tourism and Civil Aviation, international chain hotels are coming to Nepal and quality of services has been improving. This will help bring high-end tourists to Nepal.

Tourist arrival by	2012	2013	2014	2015	2016	2017	Increase in 2017
Air	598,258	594,848	585981	407412	572563	760577	32.8%
Land	204,834	202,768	204137	131558	180439	179641	-0.4%
Total	803,092	797,616	790118	538970	753002	940218	24.9%
Average length of stay (days)	12.2	12.6	12.4	13.2	13.4	12.6	-6.0%
Tourism related enterprises							
Hotel (star)	107	117	118	116	120	125	4.2%
Hotel (non-star)	746	909	957	957	942	977	3.7%
Beds (number)	31657	34523	36179	36950	38242	39833	4.2%
Travel agencies	2239	2450	2611	2768	3444	3824	11.0%
Trekking agencies	1598	1761	1903	2016	2367	2637	11.4%
Tourist guide	-	3141	3335	3507	3717	3876	4.3%
Trekking guide	-	9741	10436	11358	13049	13831	6.0%

Source: Ministry of Culture, Tourism and Civil Aviation

A senior official at the Hotel Association of Nepal concurs with the feasibility of attracting 2 million tourists by 2020. But, the construction of basic infrastructures like roads and airports, including purchase of national carriers, preservation of natural habitat, trekking trails and opening new travel destinations must be completed on time.

9 For details, please see: <https://www.outfitternepal.com/blog/nepal-features-on-lonely-planets-list-of-best-countries-to-travel-in-2017.html>

10 World Travel and Tourism Council: Travel and Tourism Economic Impact 2018 Nepal. Direct contribution refers to internal spending on travel and tourism by both residents and non-residents for business and leisure purposes. It also includes spending on travel and tourism services by the government such as museums and national parks. The total contribution of travel and tourism to GDP in 2017 was 7.8%. the total contribution also includes its indirect and induced impacts on the economy such as purchase of new aircrafts, construction of new hotels, tourism promotion fair and purchase of services such as fuel and catering services by airlines.

the major constraint to expansion and development of tourism sector in Nepal. The road networks across the country are sub-standard. Air connectivity within the country is not only limited but also unreliable. The only international airport, Tribhuvan International Airport (TIA) is unable to handle increasing air traffic and flow of passengers. Other factors hindering the sector are lack of development and expansion of tourist destinations. For instance, despite being immensely rich in natural beauty, the far-western belt of the country remains largely unexplored. Nonetheless, tourism is expected to boom in coming years with the recent surge in foreign direct investment (FDI) inflows in hotel and restaurant sub-sector emanating from increased political stability and expectation of a favorable business climate. The government is committed to completing the construction of Gautam Buddha International Airport in Lumbini, Nepal by 2019.[11] The construction of Pokhara Regional International Airport is underway. The enhancement of TIA in terms of safety and capacity building and construction of new main taxiways, runway end safety area and its extension are in the process.[12]

F. Transport services

13. Nepal's poor transport infrastructure and its limited regional connectivity has not only widened transport services trade deficit (Table 2) but also decreased export competitiveness of merchandise goods. Road networks within the country and across the border are sub-standards, thereby increasing the time taken to import and export merchandise goods. Furthermore, syndicate system in Nepal's transportation system has eroded export competitiveness. It is estimated that the syndicate system in transport sector results in a deadweight loss of around USD 27.6 million a year (Poudel, 2016).[14] Not just road connectivity but also air connectivity is in a primitive stage. Ethiopia, a land locked country, has advanced with improvement of its air transport infrastructure. Ethiopian Airlines has largely helped expand growth of the country's services export (Hollweg, 2016). Nepal should also move towards developing and expanding its air transport infrastructure. This will not only help promote travel and tourism but also airlift several high value and low volume products[15] like cardamom, ginger, lentils, tea and coffee in which Nepal has a revealed comparative advantage.

[11] For details, see: <https://myrepublica.nagariknetwork.com/news/gautam-buddha-int-l-airport-must-be-ready-by-2019/>

[12] For details, see: <https://www.adb.org/projects/38349-013/main#project-pds>

[13] Government of Nepal/ Ministry of Culture, Tourism and Civil Aviation.

[14] The Ministry of Physical Infrastructure and Transport reached an agreement with the Federation of Nepalese National Transport Entrepreneurs on 7 May 2018 to end syndicate. However, its effective implementation is yet to be seen. For details, see: <http://kathmandupost.ekantipur.com/news/2018-05-08/govt-eliminates-cartels.html>.

[15] Ethiopian horticulture grew alongside Ethiopian airlines.

Table 2: Service trade (US $ million)

	FY2015	FY2016	FY2017	FY2018
Services	278.4	92.8	27.3	19.8
Services: credit	1504.9	1305.1	1494.5	1704.8
Services: debit	-1226.5	-1212.3	-1467.2	-1685.0
Transportation: credit	27.5	36.0	79.6	93.7
Passenger services	22.9	31.4	75.6	88.9
Freight	0.0	0.0	0.0	0.0
Other	4.6	4.6	4.1	4.8
Transportation: debit	-443.5	-415.0	-442.7	-607.6
Passenger services	-158.8	-88.7	-76.7	-103.2
Freight	-227.8	-241.8	-257.1	-315.7
Other	-56.9	-84.5	-108.9	-188.8
Travel: credit	538.6	393.6	552.7	644.5
Travel: debit	-536.2	-531.7	-754.7	-764.6
O/W education	-172.0	-189.8	-330.7	-365.9
Communication services: credit	386.7	299.0	300.5	313.0
Communication services: debit	-29.8	-31.4	-8.9	-17.8
Insurance services: credit	15.1	12.1	15.4	43.7
Insurance services: debit	-46.9	-41.8	-50.7	-55.8
Government services: credit	327.4	361.3	241.1	215.8
Government services: debit	-19.9	-19.8	-12.6	-23.9
Other services: credit	209.6	203.2	305.2	394.2
Other services: debit	-150.1	-172.6	-197.5	-215.3

Source: Nepal Rastra Bank.

14. If Nepal is well-connected with its regional member countries, then this will help reduce transport services trade deficit. Nepal is a signatory of Bangladesh, Bhutan, India and Nepal (BBIN) Motor Vehicle Agreement[16] as well as Belt and Road Initiative (BRI).[17] With significant investment in infrastructures, particularly on roads and bridges and subsequent implementation of such initiatives, Nepal can reap economic benefits in the long-run.

G. Communication services

15. A study by the World Bank shows that Nepal has a revealed comparative advantage in communication services, and this is evident with Nepal being traditionally a net exporter of telecommunication services (Table 2). The surge in export of telecommunication services is the byproduct of tourism and labor migration (Hollweg, 2016). Tourists visiting Nepal use telephone services and data plan, including roaming charges. And Nepali migrant workers in various countries

[16] Nepal signed the BBIN Motor Vehicle Framework Agreement on 15 June 2015.
[17] Nepal signed the framework agreement on One Belt One Road Initiative (OBOR), also known as Belt and road initiatives on 12 May 2017.

make international calls back home, enabling the use of domestic telecommunication service providers.

16. Undoubtedly, communication is one of the growing services sectors of the country. Its coverage has considerably increased over the years especially with mobile penetration exceeding 100%. But the sector is also marred with inadequate power supply and insufficient number of telecommunication repeater towers, thus limiting the supply of communication services. Moreover, the use of communication and internet services in Nepal are costlier given the low level of per capita income and high tariff structure of telecommunication and broadband services (Ministry of Information and Communication/Government of Nepal, 2016). This has further limited its growth potential. Nevertheless, the implementation of Spectrum policy in 2013 and its first amendment in 2016, including the formulation of ICT policy 2015 are some of the notable initiations on the part of the government to expand the sub-sector.

H. Way forward

17. The growth of services trade hinges on several crucial inputs like education, telecommunication, transport and connectivity along with proactive policies favoring services trade (Ghani, (ed.) 2010). For instance, provision of fiscal incentives[18] to exporters and investors, infrastructural facility[19] for setting up an industry and trade promotion activities can help propel growth of services trade (Goswami et al., 2012). The Philippine BPO sub-sector, to some extent, has benefitted from favorable fiscal incentives. Nepal can also positively impact trade in services via proactive polices.

18. If Nepal is to leapfrog in services trade, then human resource development is imperative. Service subsectors like banking and finance, telecommunication, health and education are more skill intensive than the manufacturing sector (Jensen, 2008). This therefore necessitates skilled manpower to produce quality service products.

19. NTIS (2016) identifies healthcare and education as potential services sectors for export promotion. In fact, healthcare services have expanded at an accelerated rate with a visible growth of private nursing homes and teaching hospitals in recent years. And yet, not all healthcare services demand is met by domestic healthcare institutions, leading to a significant resource outflow seeking healthcare services. There is a

[18] Fiscal incentives can be in the form of income tax holidays, tax deductions and duty exemption.
[19] This can relate to special economic zones with dedicated facility such as power.

Box 2: Information and Communication Technology (ICT) business – a success story of Deerwalk Nepal

Deerwalk Nepal is one of the leading institutions in the country that deals with BPO, exporting ICT services to the US based company. It provides technical support and solutions through software development. It is also focused on producing skilled human resource for developing quality ICT products. The institution envisions to expand its services and provide ICT solutions to domestic market as well.

Currently, the institution provides employment to more than 300 semi-skilled and skilled IT professionals and engineers. The institution however faces a challenge of retaining skilled IT labor force.

need to formulate better health care policies[20], provide incentives and address the infrastructure bottlenecks to spur private investment in health sector.

20. IT and BPO is one of the prospective areas in which Nepal has a promising future (see Box 2). Companies like D2Hawkeye and Deerwalk have been providing IT solutions and services to foreign-based companies. Medical transcription, that is, analysis and reporting, for the global health industry has surged since the 2000s.[21] While these are some of the success stories, Nepal has miles to go to enhance and gain economic benefits from this sector. Currently, the sector suffers from infrastructure bottlenecks, poor business climate and deficiencies in policy measures (Hollweg, 2016). Capacity development in terms of producing quality IT professionals, software developers and engineers is essential for the betterment of this sector. Besides capacity development, the government needs to improve business climate in relation to good governance, transparency and efficient bureaucracy. This will help formalize and expand many informally operating services software contractors in Nepal (Hollweg, 2016). Apart from business climate, other sector-specific policy reforms are provision of risk capital and support of accelerators and incubators to IT firms. More importantly, the government should address IT infrastructure bottlenecks related to power supply and transport.

21. Greater economic benefits can be achieved via diversification of tourism related products along with development of tourism infrastructure. With conservation of natural parks and trekking trails, eco-tourism can be promoted. With greater regional connectivity, religious tourism like the Buddhist circuit can be strengthened. And with the development and exploration of other tourist destinations, more tourists can be attracted and their stay in Nepal can be lengthened. These ideas can be facilitated via improvement in the quality of roads, airports, domestic transportation facilities including the expansion of road networks.

[20] The recently promulgated Health Insurance Act 2017 is expected to protect the poor from falling into further poverty due to health issues and medical bills. However, a family of five should pay an annual premium of NPR2,500 to get health services amounting NPR50,000. The government is yet to table the new Medical Education Bill for endorsement in the Parliament. This bill is expected to ensure long-term reforms in the health and medical education sectors, largely ensuring the quality of medical education.

[21] For details, see: <http://nepalitimes.com/article/Nepali-Times-Buzz/it-is-all-about-it-in-nepal,3887>

22. While developing service-oriented industries, the maintenance of quality and safety standards of service products is equally important. At present, Nepal does not have a regulatory body to administer the production and trade in services. The issue of safety standards in adventure tourism, aviation and quality standards in hotel and restaurants has emerged time and again. Therefore, a separate government entity needs to be formed that will oversee the production and trade of service activities.

23. FDI is crucial to promotion of service sector industries. Service industries requiring huge investment, skill and technology transfer cannot grow with domestic investment alone. A joint venture with international companies is essential for domestic firms to be competitive in foreign market. This will help mobilize local investment with the added advantage of foreign know-how and technology transfer. In recent years, with the opening of electricity production to the private sector along with some legal and institutional reforms, Nepal was able to attract FDI in hydropower sector. Yet, specific reforms in relation to profit repatriation and forest clearance are needed to sufficiently attract FDI in this sector. The enactment of Foreign Investment and Technology Transfer Bill 2019 and Public-Private Partnership and Investment Bill 2019 are expected to pave way towards greater FDI inflows that will help propel service-oriented industries.

24. NTIS has identified labor services (skilled and semi-skilled professionals) as one of the services sub-sectors that can drive export growth of the country. Nepal should in fact aim for export promotion of labor services via Mode 2 and Mode 4 service delivery mechanisms. With higher proportion of working age population and lower dependency rate, Nepal can take advantage of the demographic dividend. But employment opportunities must be created to tap the labor productivity of working-age population. However, Nepal has limited timeframe to capitalize on this gain as dependency rate will increase by 2050 (Cosic et al., 2017). If trained health care professionals can be produced along with the establishment of world-class health facilities, then this will promote health tourism, i.e., mode 2 service delivery (consumption abroad) under the GATS of the WTO. Likewise, with better trained professionals in various fields such as IT, medicine, construction, hospitality and scientific research, temporary movement of natural persons, also known as mode 4 service delivery under GATS can be promoted. At present, on an average[22], 1144 migrant workers (mostly unskilled) leave Nepal for foreign employment in Malaysia, South Korea and Gulf countries. Their hard-earned money has not only helped reduce poverty but also maintain external sector stability in recent years. Had Nepali workers migrated for skilled jobs, then remittance inflows would have been much higher. Further, the growing human casualties of Nepali migrants abroad

[22] This is the daily average figure from 2010-2017.

resulting from poor work conditions and menial tasks could have been drastically reduced.

25. Despite signing bilateral air services agreements with several countries and adopting a liberal sky policy in 1992, Nepal has not been successful enough to gain from the liberalization of bilateral air services. Lack of good governance, weak institutional regime, limited capacity and failure to upgrade air safety standards have been deterring factors to benefitting from the liberalization of air services. As such, services liberalization is not the only remedy. Strengthening institutions and improving good governance must go together with services liberalization policies.

26. Finally, a sound database system is required for analysis, monitoring and evaluation of the performance of service industries including trade in services. At present, data pertaining to cross border trade, i.e., mode 1 service delivery and consumption abroad, i.e., mode 2 service delivery under GATS are available only at aggregate level.

References

Baumol, W.J., Blackman, B., & Wolff, N. (1985). "Unbalanced growth revisited: Asymptotic stagnancy and new evidence." American Economic Review, 75, 806-817.

Bhatta, G. (2014). "Structural Changes in a Small and Open Economy: Evidence from Nepal." NRB Working Paper No. 23.

Cattaneo, O., Engman, M., Sáez, S., Stern, Robert M. (2010). "International Trade in Services: New Trends and Opportunities for Developing Countries." World Bank.

Clark, C. (1940). "The conditions of economic progress." London: Macmillan and Co. Limited.

Cosic, D., Dahal, S., and M. Kitzmuller. (2017). "Climbing Higer: Toward a Middle-Income Nepal." Country Economic Memorandum. Washington, DC: World Bank

Fisher, A.G.B. (1935). "The clash of progress and security." London: MacMillan and Co. Ltd.

Ghani, E. (Ed.). (2010). "The Service Revolution in South Asia." New Delhi: The Oxford University Press.

Goswami, A.G., Mattoo, A., & Sáez, S. (2012). "Exporting Services: A Developing-Country Perspective." Washington, DC: World Bank.

Government of Nepal/Ministry of Commerce (2016). "Nepal Trade Integration Strategy 2016: Executive Summary and Action Matrix." Kathmandu: Government of Nepal/Ministry of Commerce

Government of Nepal/ Ministry of Information and Communication (2016). "National Broadband Masterplan (2016-2020)". Kathmandu. Government of Nepal/Ministry of Information and Communication

Hollweg, C.H. (2016). "From Evidence to Policy: Supporting Nepal's Trade Integration Strategy (Policy Note 3): Diversifying Nepal's Economy through a Dynamic Services Sector." Washington, DC: World Bank Group.

Jensen (2008). "Trade in High-Tech Services." Journal of Industry, Competition, and Trade, 8(3-4), 181-197. doi: 10.1007/s10842-008-0035-0

Kelaher, D., Dollery, B., & Grant, B. (2011). "Trade Liberalization in Indonesian Health Services: Prospects and Policies." International Journal of Public Administration, 34, 528-538.

Knight, K. (2002). "Trade Talk: An Analysis of the Impact of Trade Liberalization and the General Agreement on Trade in Services on Higher Education." Journal of Studies in International Education, 6(3), 209-229.

Poudel, B. (2015). "Structure of Nepal's Trucking Industry: Results from a Nationwide Survey." Available online at: <http://dx.doi.org/10.12774/eod_cr.january2015.poudelb>

Taguchi, H., & Lama, B. (2016). "Do Emigrant's Remittances Cause "Dutch Disease? The Case of Nepal and Bangladesh". Research in Applied Economics ISSN 1948-5433 2016, Vol. 8, No. 4.

Uddin, Md B. (2015). "Remittance, Foreign Aid Inflows and Dutch Disease: Evidence from South Asian Countries." Economics of Development (ECD).

Appendix 1: Country Economic Indicators

Item	Fiscal Year				
	2014	2015	2016	2017	2018R
A. Income and Growth					
1. GDP per Capita ($, current)	723.5	763.6	745.2	863.1	986.1 [a]
2. GDP Growth (%, in basic prices)	5.7	3.0	0.2	7.4	5.9 [a]
a. Agriculture	4.5	1.1	0.2	5.2	2.8 [a]
b. Industry	7.1	1.4	(6.4)	12.4	8.8 [a]
c. Services	6.2	4.6	2.4	7.4	6.6 [a]
B. Saving and Investment (current and market prices, % of GDP)					
1. Gross Domestic Investment[b]	23.5	28.0	28.7	31.8	34.1
2. Gross National Saving	45.7	44.1	40.1	45.4	43.9
C. Money and Inflation					
1. Consumer Price Index (average annual % change)	9.1	7.2	9.9	4.5	4.2 [c]
2. Total Liquidity (M2) (annual % change)	19.1	19.9	19.5	15.5	19.4 [c]
D. Government Finance (% of GDP)					
1. Revenue and Grants	20.6	20.8	23.1	24.3	25.4 [d]
2. Expenditure and Onlending	20.0	21.8	23.6	29.3	34.0 [d]
3. Overall Fiscal Surplus (Deficit)[e]	1.8	0.8	1.3	(3.2)	(6.7) [d]
E. Balance of Payments					
1. Merchandise Trade Balance (% of GDP)	(30.3)	(31.1)	(30.3)	(33.9)	(37.7) [c]
2. Current Account Balance (% of GDP)	4.6	5.1	6.2	(0.4)	(8.2) [c]
3. Merchandise Export ($) Growth (annual % change)	5.1	(3.9)	(28.7)	12.1	15.4 [c]
4. Merchandise Import ($) Growth (annual % change)	14.0	8.0	(7.1)	37.1	26.6 [c]
5. Remittances (% of GDP)	27.7	29.0	29.5	26.3	25.1 [c]
F. External Payments Indicators					
1. Gross Official Reserves ($ million)	6,938.6	8,147.7	9,736.4	10,494.2	10,084.0 [c]
Months of current year's imports of goods	10.0	11.2	14.1	11.4	9.4 [c]
2. External Debt Service (% of exports of goods and services)	8.9	8.1	9.9	10.8	8.3 [f]
3. Total External Debt (% of GDP)	17.7	16.1	17.3	15.7	17.4 [f]
G. Memorandum Items					
1. GDP (current prices, NPR billion)	1,964.5	2,130.2	2,253.2	2,642.6	3,007.2 [a]
2. Exchange Rate (NPR/$, average)	98.2	99.5	106.4	106.2	104.4 [c]
3. Population (million)	27.6	28.0	28.4	28.8	29.2

GDP = gross domestic product; R = revised;
Note: FY2018 covers 16 July 2017 to 16 July 2018.

a Based on FY2018 National Accounts Statistics. Central Bureau of Statistics
b Refers to gross fixed investment and does not include change in stocks
c Based on FY2018 annual data. Nepal Rastra Bank
d Based on FY2019 Budget Speech and FCGO's revised data
e Revenue and Grants minus Expenditure
f Based on FY2018 annual data. Financial Comptroller General Office

Sources: Ministry of Finance. FY2019 Budget Speech. Kathmandu; Nepal Rastra Bank. 2018. Macroeconomic Situation. Kathmandu; Central Bureau of Statistics. April 2018. FY2018 National Accounts Statistics. Kathmandu; Central Bureau of Statistics. 2014. National Population and Housing Census 2011 (Population Projection 2011 – 2031). Kathmandu; Financial Comptroller General Office.

Appendix 2: Country Poverty and Social Indicators

Item	Period					
	1990s		2000s		Latest Year	
A. POPULATION INDICATORS						
1. Population (million)	18.5	(1991)	23.2	(2001)	28.4	(2016)
2. Population growth (annual % change)	2.1		2.2		1.4	(2016)
B. Social Indicators						
1. Fertility rate (births/woman)	5.1	(1996)	3.6	(2004)	2.3	(2016)
2. Maternal mortality ratio (per 100,000 live births)	539.0	(1996)	281	(2006)	258.0	(2015)
3. Infant mortality rate (below 1 year/1,000 live births)	82.0	(1991)	48.0	(2006)	28.4	(2016)
4. Life expectancy at birth (years)	55.0	(1991)	62.0	(2001)	61.3	(2016)
a. Female	54.0	(1991)	63.0	(2001)	71.0	(2015)
b. Male	55.0	(1991)	62.0	(2001)	68.0	(2015)
5. Adult literacy (%)	35.6	(1996)	48.0	(2004)	66.8	(2017)
a. Female	19.4	(1996)	33.8	(2004)	54.2	(2016)
b. Male	53.5	(1996)	64.5	(2004)	75.3	(2016)
6. Primary school gross enrollment (%)	57.0	(1996)	72.0	(2004)	133.6	(2016)
7. Secondary school gross enrollment (%)	43.8	(2001)	54.4	(2004)	79.0	(2016)
8. Child malnutrition (% below 5 years old)	57.0				36.0	(2016)
9. Population below poverty line (international, %)	68.0	(1996)	53.1	(2003)	24.82	(2011)
10. Population with access to safe water (%)	45.9		82.5	(2006)	92.7	(2017)
11. Population with access to sanitation (%)	22.0	(1995)	24.5	(2006)	87.6	(2017)
12. Public education expenditure (% of GDP)	2.0		2.9	(2005)	4.4	(2016)
13. Human development index	0.341		0.429	(2005)	0.574	(2017)
14. Rank/total number of countries	152/173		136/177	(2003)	149/189	(2017)
15. Gender-related development index	0.33	(1995)	0.511	(2003)	0.925	(2017)
16. Rank/total number of countries	148/163	(1995)	106/140	(2003)	149/189	(2017)
C. Poverty Indicators						
1. Poverty incidence	42	(1996)	31	(2004)	25.16	(2011)
2. Proportion of poor to total population						
a. Urban	23.0	(1996)	9.55	(2004)	15.46	(2011)
b. Rural	44.0	(1996)	34.62	(2004)	27.43	(2011)
c. Mountain	57.0	(1996)	32.6	(2004)	42.77	(2011)
d. Hills	40.7	(1996)	34.5	(2004)	24.32	(2011)
e. *Terai*	40.3	(1996)	27.6	(2004)	23.44	(2011)
3. Poverty gap	11.75	(1996)	7.55	(2004)	5.43	(2011)
4. Poverty severity index	4.67	(1996)	2.7	(2004)	1.81	(2011)
5. Inequality (Theil Index)	…		…		…	
6. Multidimensional poverty index[1]	…		…		0.116	(2015)

... = not available, GDP = gross domestic product,

Sources: Central Bureau of Statistics. 2012. National Population and Housing Census 2011. Kathmandu; Central Bureau of Statistics. 2014. National Population and Housing Census 2011 (Population Projection 2011-2031). Kathmandu; Central Bureau of Statistics. 2017. Annual Household Survey 2016/17. Kathmandu; Ministry of Health. 2017. Nepal Demographic and Health Survey 2016. Kathmandu; United Nations Development Programme. 2017. Human Development Report 2016. New York; Central Bureau of Statistics. 2011. Poverty in Nepal (2010/11). Kathmandu; Ministry of Finance. 2016. Budget Speech of FY2016/17. Kathmandu; World Bank. World Development Indicators database. https://data.worldbank.org/ (accessed 25 February 2019).

1 UNDP replaced Human Poverty Index with Multidimensional Poverty Index from Human Development Report 2011.

ADB

ASIAN DEVELOPMENT BANK
6 ADB Avenue, Mandaluyong City
1550 Metro Manila, Philippines
www.adb.org

ADB NEPAL RESIDENT MISSION
Metro Park Building, Lazimpat
Post Box 5017, Kathmandu, Nepal
adbnrm@adb.org
www.adb.org/nepal
www.facebook.com/adbnrm/