

Impact of Trade Development in Poverty Reduction in Nepal

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Abstract

Trade is essential for economic development, employment creation and poverty reduction of the country. It is necessary to look forward towards the import and export sector of the country for prosperous economic growth. Nepal has undertaken extensive trade liberalization since 1990. The volume of World Trade in terms of goods and services increased by 2.2 percent in 2016 and reached around 3.8 percent in 2017. The World economy increased by 3.6 percent in 2018 and is expected to grow by 3.3 percent in 2019. The GDP at basic price increased by 6.3 percent in 2018 and it is estimated to increase by 6.8 percent in 2019. Similarly GDP at producer price was 6.7 percent in the 2018 and 7.0 percent in 2019. The contribution of non-agriculture sector to GDP is estimated to be 73 percent in 2018/19. Due to improvement in trade and services, the non-agriculture sector is estimated to expand by 7.5 percent in 2018/19. In Nepal, the first trade policy was introduced in 1983 with the slogan "Exports for Development". Also a new trade policy was brought in 1992. Due to changes in development and growth, trade policy was again revised in 2009. Various challenges were faced in order to decrease poverty and increase economic growth so the government introduced a new trade policy, 2015. The poverty reduced to 42 percent in 1996 against 31 percent in 2004 and 25.2 percent in 2011. Similarly, per capita income is increased by 1.7 percent and poverty is decreased by 1.4 percent every year. This study therefore focuses on the contribution of each sector to maintain balance in trade. Export oriented growth is the concrete impact on poverty reduction.

Keywords: Trade development, poverty reduction, income, consumption, export, import, liberalization, employment.

Introduction

Nepal is among the least developed countries in the world. Trade is the key component of economic development in our country. The volume of World Trade in terms of goods and services increased by 2.2 percent in 2016 thereby encouraging trend of improvement in the economic activities and growth rate compared to previous year. The value reached around 3.8 percent in 2017. The World economy increased by 3.6 percent in 2018 and is expected to grow by 3.3 percent in 2019. The World Trade according to IMF indicated the growth by 2.7 and 2.2 percent in 2015 and 2016 respectively (MOF, 2016). Similarly, the IMF estimated that the growth of Nepalese economy will be 0.01 percent in 2016 and 6.94 percent in 2017 (MOF, 2017). The World economy according to IMF indicated the growth by 7.9 and 6.3 percent in 2017 and 2018 respectively. The value reached around 6.5 percent in 2019. The GDP at basic price increased

by 6.3 percent in 2018 and this is estimated to increase by 6.8 percent in 2019. Similarly GDP at producer price was 6.7 percent in the 2018 and in 2019 it is estimated to be increased by 7.0 percent (MOF, 2019).

Nepal has undertaken extensive trade liberalization since 1990. Trade liberalization is a key component of economic policy. It has positive effects on resource allocation, economic growth and poverty reduction. Agriculture and Non-agriculture GDP are estimated to have a growth of 5.0 percent and 7.5 percent in 2018/19, against 2.8 and 7.7 percent growth rate in 2017/18 (MOF, 2019). The contribution of agriculture and non-agriculture sector to GDP is estimated to be 27 percent and 73 percent in 2018/19, which was 28.1 percent and 71.9 percent in 2017/18. Due to improvement in trade and service non-agriculture sector is estimated to expand by 7.5 percent in 2018/19. The wholesale and retail trade will have the highest contribution to GDP with 23.1 percent in 2018/19 (MOF, 2019).

External sector liberalization and open economy of economic policies are the main criterions for high economic growth and poverty reduction. This has contributed to income creation and employment generation. But trade sector and industrial liberalization does not automatically contribute to achievement in poverty reduction. The linkages of industry and trade to local resources, labour intensity of these activities and labour market condition are equally important for that situation. However, trade liberalization is a key component of the economy that has positive effects on resource allocation, economic growth and poverty reduction (Khatriwada, 2005).

Objective of the Study

- The main objective of the study is to focus on the impact of trade in poverty reduction in Nepal.
- To elaborate the relationship of agriculture, income and poverty, employment and GDP with trade and its impacts.

An Overview of Trade

The household operating non-farm activities in 1995/96-2003/04 has increased from 14 percent to 28 percent. The share of trade was the largest, resulting the value to 52 percent. Similarly, the share of manufacturing and services are 30 percent and 14 percent respectively. In the recent years, Nepal has maintained broad macro economic stability, which further provides improvement in the overall external balances. The structure of Nepalese trade is altering over the years with the changing structure of production. Basically, from primary goods exporting country in Mid 1980s, Nepal has now turned to manufacturing good exporting country. Production of readymade garments, woolen carpets and pashminas account more than 60 percent of the country's total export. The structure of imports is recently changing with growing imports of primary and capital goods.

The strong positive relations between economic growth and openness to trade has supported the elimination of poverty. Export oriented growth is the concrete impact on poverty reduction. There are mainly two ways to consider the extent to which international trade may

contribute to poverty reduction. First, examine the impact of trade on growth in GDP, on changes in income distribution and on related sustainable improvements in human development at the macro level. Second, the impact of economic and social development in poor communities of export oriented poverty reduction projects. So trade affects poverty through its effects on growth and income distribution. Trade is not only associated with faster economic growth, but also with net improvement on social sector like education, life expectancy, infant mortality and even water quality.

Review of Literature

Ali Tariq, Hafeez Muhammad and Kiani Adiq (2018) focused on trade that it plays a very crucial role to alleviate poverty. It is a very influential element on the macroeconomic policies which has added much more to the economic development. Every country wants to enhance the productivity through the exchange of goods, skills, knowledge and expertise. Countries with good trade are able to enhance the availability of choice, improve the income level and raise the prospects for enrichment of technical change. So trade and development run in a parallel way. The study focused that the trade openness has a positive impact on the per capita income of the agricultural and non-agricultural sector.

WTO (2018) suggested that trade openness is the key to poverty reduction. Trade influences the income of the poor through various channels such as: effects on economic growth, relative prices, macroeconomic stability and government revenues. Also the impact of trade on poverty reduction depends on decisions within the households on how income is allocated. The effect of trade on the poor depends on the industry or firm where the poor work. The study highlighted that trade can allow producers to get better access to material and services and the technology that improves productivity in the production of the goods and services produced by the poor people. Besides trade reforms can create new opportunities for the poor people.

Warrad Taleb Awad and Buthaina M.A. Muhtaseb (2017) highlighted the relationship between trade and poverty reduction through economic growth and employment. Although the impact of trade on poverty is a very difficult and complex task. But it can be seen as the result of interaction between different socio-economic and institutional factors. Similarly different theoretical models identified different linkages between two variables. The study also focused on the link between trade and poverty and considers other variables (growth and employment) which constitute the channels between trade openness and poverty reduction. The main goal of the study is to combine theoretical analysis and econometric models to assess the interconnected associations between four variables such as trade, economic growth, unemployment and poverty. The study provided evidence that trade liberalization and other openness policies have contributed significantly to economic growth. Remittances, external trade and FDI are the main determinants of economic growth.

Mitra Devashish (2016) investigated that trade has to be an engine of growth. Trade enhances growth and that growth in turn reduces poverty. The implication of these arguments is that growth occurs and introduces trade reform. The study according to standard trade theory, trade liberalization in developing countries is expected to benefit countries with unskilled labour,

their most abundant factor of production, leading in turn to poverty reduction. So the study hence concluded that trade increases income and economic growth in order to reduce poverty.

WTO and WB (2015) explored on how sustained efforts can lower trade costs and integrate global markets to maximize the gains for the poor. It offers strategies on how to support further integration of the poor into global trade by lowering trade costs in a way that maximizes the gains and minimize the risks. The study has mainly three messages; (i) sustains effort to deepen economic integration and further lower trade costs is essential for ending poverty (ii) lowering tariffs and non-tariff barriers between countries are essential elements of this heading but this must form part of a wider approach that recognize the specific constraints facing the extreme poor (iii) WTO and WB group have made substantial contributions to trade and poverty reduction. So the study focuses on the need for sustainable efforts to keep global trade open and lower trade costs by further integrating markets. Moreover institutions need to continually review their activities to support poverty reduction.

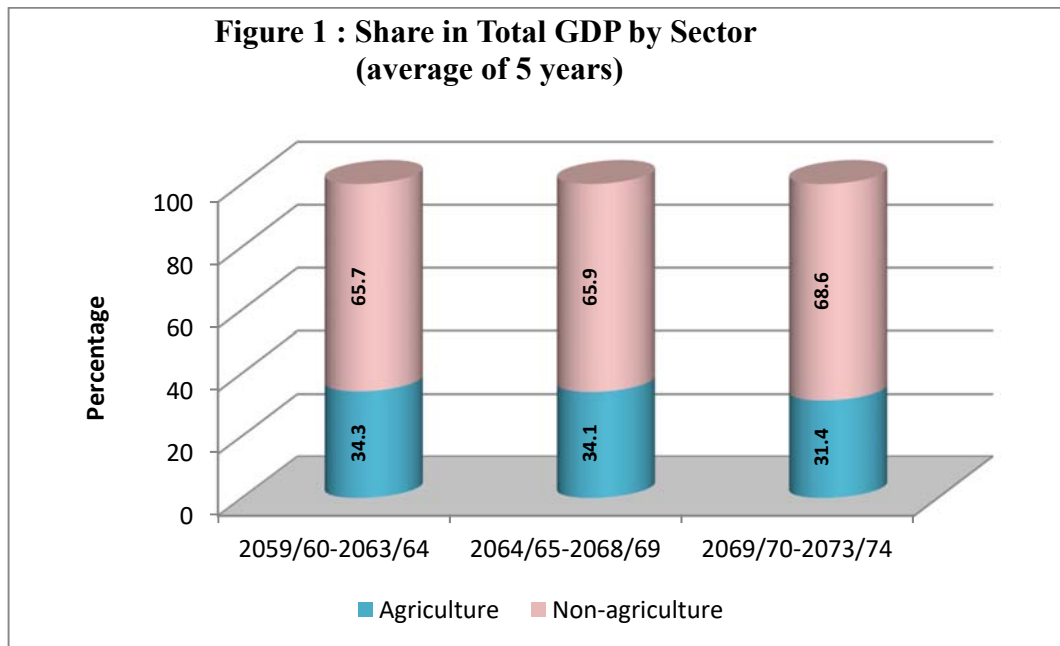
OECD (2008) investigated the link between trade, economic growth and poverty reduction has been dominated by a discussion on the impact of trade liberalization on poverty reduction. Trade liberalization is the most obvious policy instrument for increasing trade capacity. The study focused on what we know about the impact of trade on economic growth and poverty reduction. The evidence concerning trade is an impact of economic growth that varies considerably across countries. The study hence highlights that the broader development community needs to acknowledge that trade integration is an important element in achieving sustainable economic development.

Methodology

The study is to provide effective data and information by analyzing and making a fresh study of the “Impact of Trade Development in Poverty Reduction in Nepal”. The study is mainly based on secondary sources of information and study approach are analytical and descriptive. The data used in this study are published in journals, government publications like various issues of economic survey of the Ministry of Finance, Nepal living standard survey of the Central Bureau of Statistics, various plan period documents of the National Planning Commission, Nepal Rastra Bank Bulletin as well as published reports of international organizations such as ADB, IMF, UNDP, WB, WTO.

Trade and Agriculture

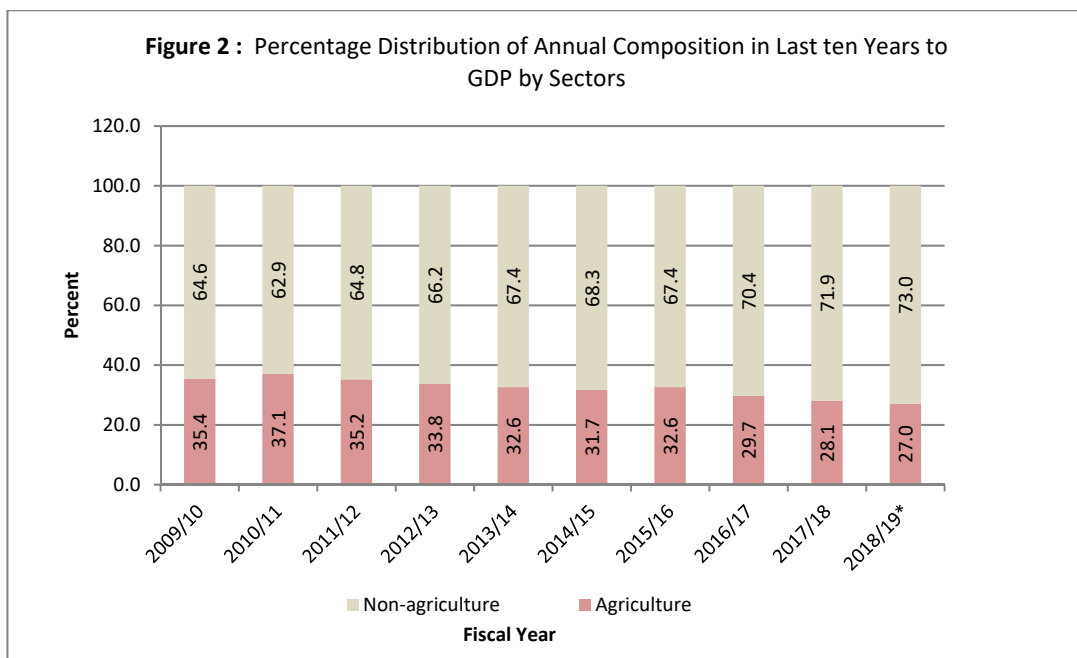
Agriculture plays key role in the Nepalese economy. Nepal is an agro-based country. Agriculture is the main source of livelihood for the Nepalese people. The dependence on agriculture of the total population is about 70 percent, it is almost two-thirds of the population, which indicate that the main source of livelihood for the Nepalese people is agriculture. Around 66 percent of the economically active population is engaged in this sector. The agriculture GDP is 27 percent in 2018/19. Hence agriculture sector indicates the importance of a broad-based agricultural growth for poverty reduction. Likewise, non-agriculture sector has same importance after the agriculture sector in the economy. The share of non-agriculture sector GDP is 73 percent in 2018/19. The agriculture sector GDP is in decreasing rate in last 15 years (Figure 1).



Source: MOF, Kathmandu, Nepal.

The average economic growth rate is 4.6 percent in the past ten years (2009/10-2018/19). During this period, agriculture and non-agriculture sector average growth rate is 3.1 percent and 5.3 percent respectively. Due to earthquake and road blockage in 2015/16, the economic growth was slow which later improved in 2016/17 and became 7.3 percent. In this way, the contribution of agriculture sector to total GDP production is in a decreasing rate whereas non-agriculture sector is in an increasing rate. Hence in 2018/19 the share in the total GDP production due to the non-agriculture sector is estimated to be 73 percent. Therefore, the contribution of agriculture sector to GDP in last ten years is decreasing annually (Figure 2).

The effects of trade reform on poverty depend partially on changes within the agriculture sector. Liberalization expect positive effects on agricultural growth on rural poverty. Trade reform is seen to be providing improved incentives for agricultural production. It is also predicted to induce subsistence agriculture in cash crops and increased incomes for the poor's. The effects of liberalization on poverty also depend upon the rural poor, which are largely net sellers or buyers of agricultural production. If there is rise in food prices the majority of the poor net buyers of food could lead to increased poverty. But if there is entry of cheap imports then a fall in agricultural prices is seen. Trade liberalization is supposed to support commercialization of agriculture by domestic and creating export market, hence smoothing the supply of inputs and bringing excess labour from agriculture to non-agriculture sector.

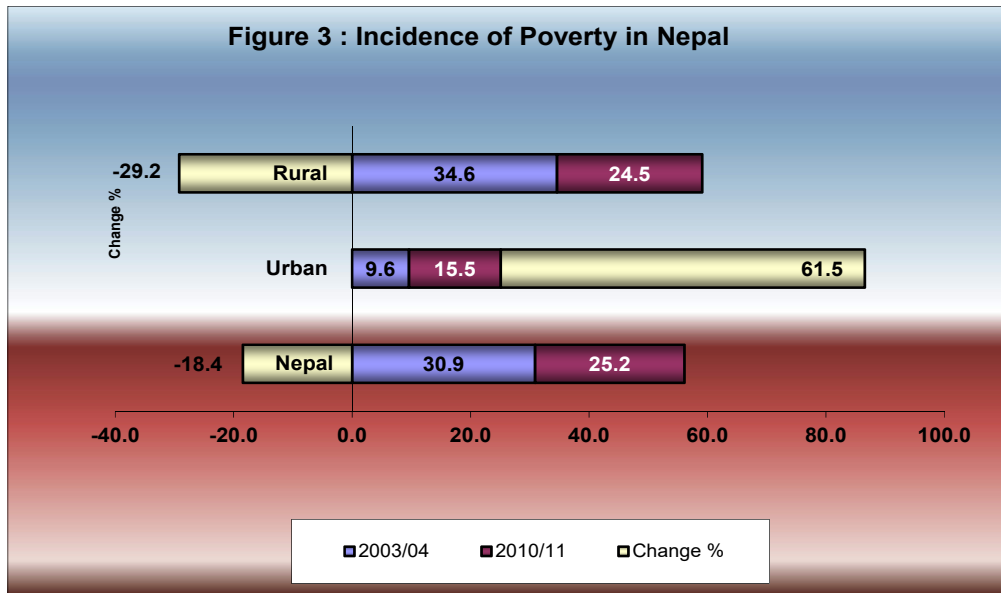


Source: MOF, Kathmandu, Nepal. *Estimated

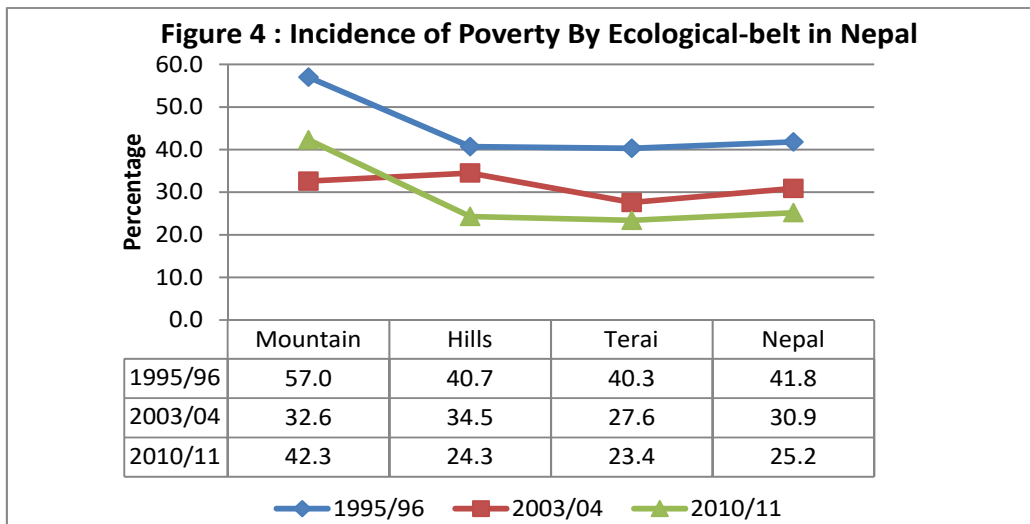
Trade Policy, Income and Poverty and Employment

In Nepal, the first trade policy was introduced in 1983 with the slogan of “Exports for Development” in Nepal. With the wave of economic liberalization and structural adjustment program, Nepal has brought out a new trade policy in 1992. This gives emphasis on the trade regime in the line of overall economic growth. The strategy of this new trade policy has changed the development scenario. The policy has export oriented economic growth strategy. Nepal faces unemployment problem, in both like educated and uneducated. New trade policy helps to explore the possibility of sending Nepalese labour overseas for jobs. This is also liberal in the sense that it licenses export and imports sector, given the changed context of Nepal introduced Trade Policy, 2009. Challenging the poverty reduction and rapidly economic growth in the country, considering the dynamism in the trade sector and addressing alarming trade deficit, the government introduced new trade policy, 2015.

The problem of unemployment and underemployment are high in the country. Trade is going to be deficit if opportunities for transfer income are limited. External income mainly compensates them. NLSS 2003/04 estimated population below poverty line in 2004 to be 31 percent. It is declined by 11 percent from 42 percent in 1995/96. The share of rural areas poverty decline was 9 percent (from 43.3 to 34.6 percent) in 1995/96 and 2003/04 respectively. Similarly, 12 percent (from 21.5 percent to 9.5 percent) decline in urban areas in 1995/96 and 2003/04 respectively. Recently (in 2010/11) about one quarter of its population living below poverty line (Figure 3 & Figure 4).



Source: CBS, 2010/11.



Source: CBS, 2010/11.

The nominal per capita in 2010/11 is estimated to go up to Rs. 41,659 from Rs. 7,960 in 1995/96 and Rs. 15,162 in 2003/04. Likewise, nominal per capita consumption is estimated to be Rs. 6,802, Rs. 15,848 and Rs. 34,829 in 1995/96, 2003/04 and 2010/11 respectively. The share of farm income, non-farm income and other incomes are 61 percent, 22 percent and 17 percent in 1995/96, 48 percent, 28 percent and 25 percent in 2003/04 and 28 percent, 37 percent and 35 percent in 2010/11 respectively (Table 1 and Table 2).

Table 1: Nominal Income, 1995/96-2010/11

Description	1995/96	2003/04	2010/11
Nominal average household income (NRs)	43,732	80,111	202,374
Nominal average per capita income (NRs)			
All Nepal	7,690	15,162	41,659
Poorest 20 % population	2,020	4,003	15,888
Richest 20 % population	19,325	40,486	94,149
Share of farm income in household income (in %)	61.0	47.8	27.7
Non-farm income	22.0	27.6	37.2
Others income	17.0	24.5	35.1

Source: CBS, 2010/11.

Table 2: Nominal Per capita Consumption, 1995/96-2010/11

Description	1995/96	2003/04	2010/11*
Nominal per capita Consumption (NRs)			
All Nepal	6,802	15,848	34,829
Poorest 20 % population	2,571	4,913	13,168
Richest 20 % population	15,243	42,236	78,504
Share of nominal per capita Consumption			
Poorest 20 % population	7.6	6.2	7.6
Richest 20 % population	44.9	53.3	45.1

Source: CBS, 2010/11.

Figure 5 : Household Income in 2003/04 (%)

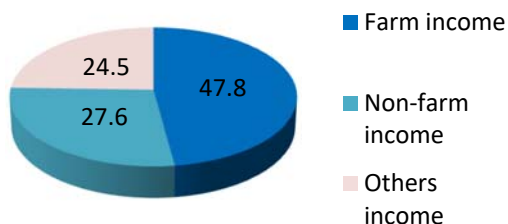


Figure 6 : Household Income in 2010/11 (%)

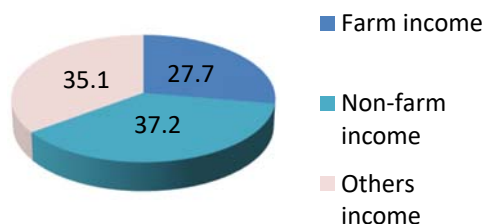


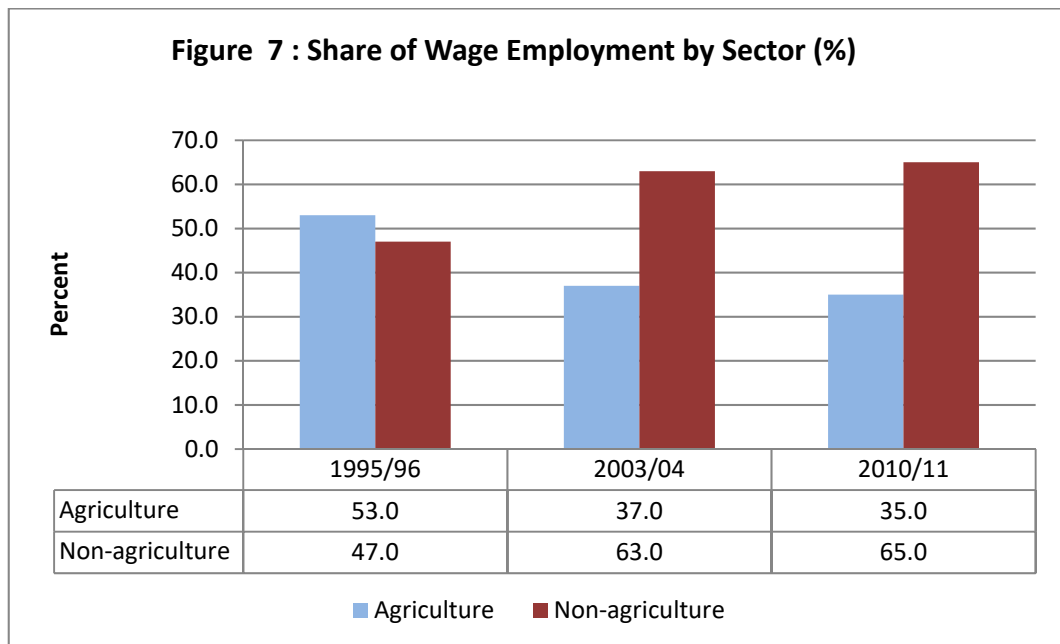
Table 3 : Share by Main Sector of Employment

(in percent)

Description	1995/96	2003/04	2010/11
Wage employment (agriculture)	12.2	6.8	2.8
Self employment (agriculture)	70.7	64.3	61.3
Wage employment (non-agriculture)	9.5	10.2	12.6
Self employment (non-agriculture)	7.7	9.3	12.7
Agriculture sector wage employment	53.0	37.0	35.0
Non-agriculture wage employment	47.0	63.0	65.0

Source: CBS, 2010/11.

The structure of employment of the country is favorable. Under the wage employment, the share of agriculture and non-agriculture employment was 12.2 percent and 9.5 percent in 1995/96, 6.8 percent and 10.2 percent in 2003/04 whereas 2.8 percent and 12.6 percent in 2010/11. Similarly, in 1995/96 and 2003/04, the share of non-wage (self employment) in agriculture and non-agriculture employment were 70.7 percent and 7.7 percent and 64.3 and 9.3 respectively. Also, 61.3 percent and 12.7 percent of agriculture and non-agriculture employment in 2010/11 (Table 3). The share of wage employment and non-wage employment are shown by the following figure (Figure 7).



Contribution of Trade to GDP

The structure of the economy has not obtained rapid change over the years. Contribution

of agriculture sector in GDP declined by about 1 percent annually during the 1990s, where as non-agricultural sector was favorable in that period. Basically, trade component had more favor on the non-agriculture sector. The share of agriculture sector in GDP is about 29 percent during recent years (MOF, 2016/17).

Share in the trade sector is increased specially in the 1990s. This is the consequence of expansion of export oriented industries and liberalization of the economy. The agricultural sector contribution to GDP in 2009/10, 2010/11 and 2011/12 is 35.3 percent, 35.5 percent and 35.6 percent respectively. But the share of industry and services including trade sector is 64.7 percent in 2009/10, 64.6 percent in 2010/11 and 64.4 percent in 2011/12 (Table 4). So the non-agriculture sector contribution is very high than the agriculture sector in recent years and trade is vital component of non-agriculture sector.

Table 4: Sectoral Contribution to Gross Domestic Product (%)

Sectors	2009/10	2010/11	2011/12	% change	
				2010	2011
Agriculture	35.3	35.5	35.6	0.7	0.4
Industry	15.0	14.9	14.5	-0.9	-2.8
Services	49.7	49.7	49.9	-0.2	0.5

Source: NRB, 2011/12.

External Trade and Poverty

The conceptual framework of trade, growth and poverty linkages are the key points to analyzing trade development and poverty reduction in the economy. External sector liberalization and openness economy of the economic policies play an important role in attaining high economic growth and poverty reduction. Income creation and employment generation both are the main criterions for this to happen. International trade also plays vital role for poverty reduction with the links between trade and poverty.

There are so many direct channels through which trade affects poverty;

- (i) income and employment effects
- (ii) expenditure effects arising to price changes, and
- (iii) effects on revenue which affect resource allocation for public goods and anti-poverty programs.

Indirect effects through economic growth, increased investment, technology acquisition and learning.

Pattern of External Trade, Economic Growth and Poverty Reduction

Nepalese economy measured in terms of total trade volume to GDP ratio is relatively more than 50 percent. In Nepal, meaningful international trade began only since the 1960s. Broadly, Nepal's international trade accelerated since 1980s. In that period, exports increased on an average rate of 19 percent, and imports increased by 18 percent during this period. In the 1990s, exports increased on an average rate of 28 percent whereas imports also increased by 20

percent on average (Table 5).

Table 5: External Sector Indicators (in Growth Rates)

Items/Year	1981-90	1991-2000	2001-05
Exports	19.0	28.0	3.7
Imports	18.0	20.0	4.4
Trade deficit	19.4	17.2	5.3
Service Exports	3.2	12.8	-1.4
Service Imports	7.0	2.7	6.7

Source: MOF and NRB (various issues).

The service sector was rapidly growing during the early 1990s. But it could not be maintained thereafter in the same way. In the recent years, service sector has been growing external labour which hence absorbs labour force, increases income of the lower income group households. Therefore, it contributes to foreign exchange reserves of the country.

Effects of Trade Reform on Poverty

The effects of trade reform on poverty in Nepal is rural phenomena. The high incidence of poverty is in rural areas. About 83 percent (census 2011) of the total population still lives in rural areas. So the effects of trade liberalization on poverty must focus on income generation and employment creation for the rural people. However, in relation to poverty which has been reduced in recent years. it was 42 percent in 1996 against 31 percent in 2004 and 25.2 percent in 2011. Similarly, per capita income is increased by 1.7 percent and decline in poverty by 1.4 percent every year.

Conclusion

Trade policy reform in Nepal has been taken since 1990s. The effect of trade policy reform on poverty through income growth, employment and wages are very limited. The analysis of poverty reduction in Nepal is dependent upon the income generation aspect with respect to the indicators of human development and overall social economic activities. According to Nepal Living Standard Survey (NLSS), poverty has been reduced from 42 percent to 31 percent in 1996 and 2004 respectively. Recently, it is 25 percent as measured in 2010/11. The declining rate of poverty during the period is 1.4 percent every year. A comparison of poverty level between the rural and urban sector estimate that (from 43 to 35) and (from 22 to 10) percent in 1995/96 and 2003/04. It is declined by 8 percent and 12 percent in rural as well as urban sector. Similarly, poverty level between the rural and urban sector estimate (from 35 to 25) and (from 10 to 16) percent in 2003/04 and 2010/11. It is declined by 10 percent and increased by 6 percent in rural as well as urban sector. So there has been an improvement in poverty gap in rural areas.

The contribution of trade sector is continuously increasing the economic growth of the country. Increase in internal and external trade decreases trade deficit and reduces poverty. Employment opportunity, increase in income and improvement in lifestyle of the people have been created in the country due to trade development. Thus, development of trade plays an important role in poverty reduction. Nepal's international trade has been suffering from deficit which can have negative impact on trade development and foreign currency reserve of the country, which therefore creates economic instability. Import substitution policy is needed to solve them and also promote competitive industries in the international markets. Therefore, government should encourage the policy of investment for export oriented industries and promotion of export and substitution of import. Rapid expansion of employment opportunities in the private sector requires growth of small enterprises. Enterprises development for the self-employed needs to be a focus of trade development and poverty reduction.

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