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Inclusive growth experiences - the case of Nepal: A discussion on a paradox from conventional and holistic perspectives

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Asia-Pacific Research and Training Network on Trade

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Dr. Nephil Matangi Maskay and Dr. Shiva Raj Adhikari

No. 125/June 2013

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Dr. Nephil Matangi Maskay and Dr. Shiva Raj Adhikari¹

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Abstract

Country insights vary according to analyses of their inclusive growth (IG) experiences. Looking at the trends in stylized facts of Nepal, a land-locked, least developing country in South Asia, is at first glance paradoxical. That is, Nepal experienced a costly domestic insurgency situation from the early 1990s. This, however, was accompanied by a sharply decreasing trend in poverty headcount rate from 41.8% in 1996 to 30.9% in 2004 and 25.2% in 2011. This result is attributed to labour migration and a sharp growth in the remittances-to-gross domestic product (GDP) ratio; in 2011/12 it was about 23%. The conventional IG explanation highlights the contribution of remittances to household income and poverty reduction. However, households are spending remittances largely on consumer activities; therefore, this situation is labeled as “short-term” IG. Using a broader and holistic system-wide perspective suggests that there are both intended (positive/negative externalities) and unforeseen consequences. The unforeseen consequences are the societal changes as well as positive externalities of remittances in Nepal, which have facilitated an increase in access to services. The latter perspective changes the analysis and reverses the priority of policy recommendations, thus providing a cautionary note to policymakers in formulating policy prescriptions.

JEL Code: O15

Keywords: inclusive growth, Nepal, poverty, Gini coefficient, remittances

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Introduction

Poverty reduction is the ultimate goal of almost all policymakers in developing countries. To achieve this, the dominant view in the early 1970s was that economic growth could be a primary objective of economic policy, as it would contribute to poverty reduction. However, with liberalized markets, a period of accelerated economic growth followed. This led to a reduction in overall poverty levels, a situation that also resulted in increasing income inequality (partly as a result of wide-spread market failures and follows discussion on the inverted U-shaped relationship between income inequality and economic growth – called the Kuznets curve) and which contributed to social tension and, in the extreme, economic and political instability (United Nations, 2010). In other words, the different components of society did not respond equally to economic growth and the subsequent poverty reduction. To address this issue of unequal poverty reduction, policymakers have focused on the quality of growth, (see, for example, Bourguignon, 2003; Vetterlein, 2007; and Ali and Son, 2007) while acknowledging that growth is a necessary contributor (yet also suggesting that a slow and low growth rate has limited power to generate employment). In this regard, there have been many alternative policy schools of thought such as having pro-poor growth or broad-based growth (Klasen, 2010). However, one recent line of thought has been support for inclusive growth (IG), which is described as growth that allows all members of society the opportunity to participate in, and contribute to the growth process.

While there is no widely accepted definition of IG, the following description given by Ianchovichina and Lundstrom (2009) appears balanced (and is thus appropriate for use by this paper): “Inclusive growth refers both to the pace and pattern of growth, which are considered interlinked. In other words, inclusive growth focuses on productive employment (and its opportunities) rather than on income redistribution, and that there should be equality of opportunity for individuals and firms within an economy.” IG therefore takes a longer-term perspective, as its focus is on productive employment, rather than on direct income redistribution, as a means of increasing incomes for excluded groups. The literature suggests that economic growth and productive employment opportunities have a negative and generally linear relation with poverty levels, i.e., they either generally estimate IG using a cross tab of input versus outcome or use the Ordinary Least Squares (OLS) estimation method.

However this narrower analysis, described in this paper as the conventional perspective, gives less importance to the system-wide effects and consequences among the actors of an economic system. On the other hand, this later and broader analysis, which is referred to in this paper as a holistic perspective, provides more extensive insight and information for policymakers by including economic system-wide effects such as access to services (e.g., education, finance, health care, markets etc); which internalises the apparent externalities in measuring growth, and analyses the growth process with solid economic reasoning on how the economic variables and people change their behaviour to make positive changes in output. Thus, it is suggested that a much broader and wider body of data, both from a qualitative and a quantitative approach, can provide the system-wide effects than data that result simply from a statistical analysis. This paper uses both these perspectives on IG (i.e., conventional and holistic) through a case study on the experience of Nepal, a land-locked, least developing country in South Asia, where trends in stylized facts have been contrary to expectations. The country experienced a decreasing poverty trend in the face of a costly domestic insurgency, which resulted in a contraction of domestic productive employment opportunities).

The objective of this paper is to discuss this paradox from the case perspective, using methodology based upon qualitative analysis from publicly available data as well as the three National Living Standard Survey (NLSS) data sets to provide: (a) a discussion on trends in stylized facts; (b) an analysis from both a conventional perspective and a broader, holistic perspective; and (c) a general insight and comments.

Jumping ahead, the insight gained from this paper is that using a holistic approach (versus conventional perspective) to analyse the stylized facts is necessary to gain a more detailed diagnosis. This paper also provides a cautionary note to local policymakers, (and which can be applied by all policymakers) regarding both diagnosis and formulation of policy prescriptions. However, in preparing this paper, the authors faced several limitations, such as the present domestic fluid political situation and issues with data quality.

1. Overview of Nepal

Nepal is a land-locked, least developing country in South Asia, located between China to the north and India to the west, south and east (see figure 1).

Figure 1. Map of Nepal



Source: <http://ncthakur.itgo.com/map.htm>.

Area	147,181 km ²	
Population (2011 Census)	26,494,504	
GDP growth 2011/2012	4.63%	
GDP growth	Average	St.
1984/85-2011/2012 (whole)	4.54%	Deviation
1984/85-1994/1995	4.94%	0.016228
1995/96-2002/2003	4.23%	0.018906
2003/04-2009/2010	4.29%	0.019456
2010/2011	4.27%	0.009846

Source: Government of Nepal.

Although the history of unified Nepal starts from the late eighteenth century, this paper focuses on the period after 1990, which marks both a regime shift from absolute monarchy to a constitutional monarchy with parliamentary democracy as well as the start of economic liberalization. During this period, many international/non-government organizations came into existence with the objective of social development in the rural areas of the country. In this regard, the population and the private sector were encouraged to undertake joint activities in the newly liberal society, with the main focus on economic activity in some urban areas. With liberalization, annual GDP growth climbed quickly and reached a maximum of 8.22% in

1993/94;² unfortunately, this economic growth was accompanied by growing inequality. While there is no statistical evidence of this change, the situation fuelled social tension and led to the initiation of domestic armed insurgency from mid-1990. This decade-long insurgency resulted in tremendous economic, social and human cost through significant damage to property and infrastructure. This situation, in turn, contributed to a contraction of the manufacturing and industrial sectors and subsequently to GDP. The insurgency resulted in approximately 13,000 deaths of Nepalese nationals during the conflict period together with massive dislocation and displacement of the population (INSEC, 2013).

However, the same period saw changes from traditional ways to a more “modern” approach to dealing with society, which was also associated with a broadening of the horizons of the population (Lawoti, 2007; Seddon and Hussein, 2002), together with enhancement of access to different services. The development process and the resulting equilibrium point from the social perspective had thus shifted.

The period of domestic insurgency ended in 2007 with the Comprehensive Peace Agreement, and Nepal started the process of writing a Constitution, having elected a Constituent Assembly. Unfortunately, the process is still ongoing, with the term of the Constituent Assembly having expired and the exercise still being undertaken by an elected government to form another Constituent Assembly.

The economy has also seen a transformation from one that is based largely on agriculture to one based on services. In the 1970s, the contribution by agriculture was more than 70% of GDP, with the service sector accounting for about 15% of GDP. Currently, agriculture accounts for a contribution of slightly more than 30% to GDP while services contribute more than 50% of GDP. This reflects a significant transformation in the domestic economy.

The discussion in this paper is based on secondary data from three national-level household surveys – NLSS I, II and III in 1996/1997, 2003/2004 and 2010/2011. A summary of these surveys is provided in table 1.

² The fiscal year starts from mid-July to the following mid-July; thus 1993/94 covers mid-July 1993 to mid-July 1994.

Table 1. Summary of NLSS coverage

Description	Nepal Living Standard Surveys		
	NLSS I	NLSS II	NLSS III
Number of primary sampling units cross-sectional data	274 (3 373) households)	326 (3 912 households)	499 (5 988 households)
Survey methods	Living standard measurement survey	Living standard measurement survey	Living standard measurement survey
National representative survey	Covering all development regions, rural/urban and ecological belts	Covering all development regions, rural/urban and ecological belts	Covering all development regions, rural/urban and ecological belts
Coverage of surveys	Household information, income, consumption, saving, education, health care, remittance, government facilities, among others	Household information, income, consumption, saving, education, health care, remittance, government facilities, among others	Household information, income, consumption, saving, education, health care, remittance, government facilities, among others

Source: Nepal Living Standard Surveys conducted by the Central Bureau of Statistics during 1995/1996, 2003/2004 and 2011/2012, respectively.

Looking at the poverty indicators in the three NLSS categories (table 2) suggests that a sharply decreasing poverty trend occurred during the survey periods. In addition, there is also consistency of the poverty statistic in NLSS I (i.e., 41.76%) with that of the Multi-Purpose Budget Survey conducted by Nepal Rastra Bank in 1985, which showed that the poverty level was 42.5% in that year):

Table 2. Poverty in Nepal

	Head count index (%)			Poverty Gap Index (%)			Squared Poverty Gap Index (%)		
	NLSS I	NLSS II	NLSS III	NLSS I	NLSS II	NLSS III	NLSS I	NLSS II	NLSS III
Nepal	41.76	30.85	25.16	11.75	7.55	5.43	4.67	2.7	1.81
Urban	21.55	9.55	15.46	6.54	2.18	3.19	2.65	0.71	1.01
Rural	43.27	34.62	27.43	12.14	8.50	5.96	4.83	3.05	2.00
Gini	34.00	41.00	33.00						

Source Nepal Living Standard Surveys conducted by the Central Bureau of Statistics during 1995-1996, 2003-2004 and 2011-2012, respectively.

Table 2 also suggests that there has been a sharp decrease in income inequality, captured by the Gini coefficient that decreased from 0.41 in NLSS II to 0.33 in NLSS III. However, this figure has be considered in perspective, given its erratic nature since in NLSS I it was 0.34.

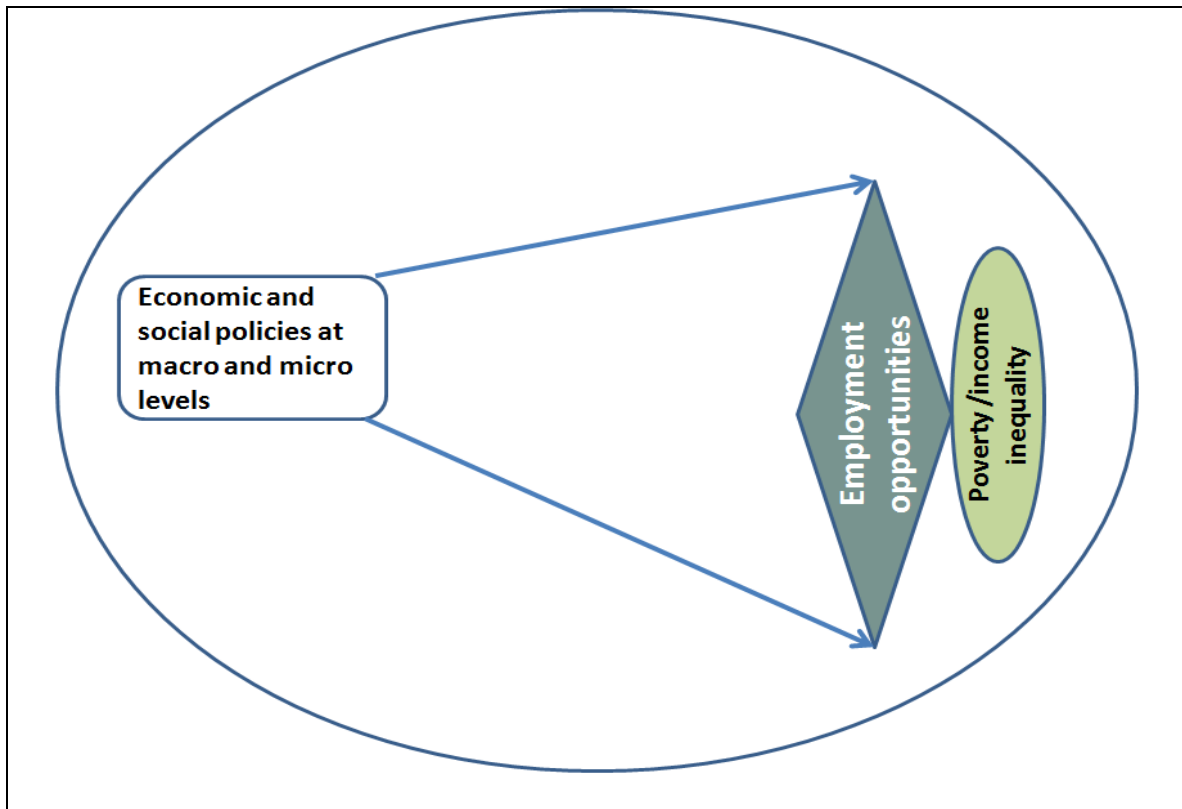
Nonetheless, the trends in stylized-facts are paradoxical as they show an opposite relationship from that expected for the literature on IG as discussed above. (This presents a policymaker with a conundrum with regard to what policy prescriptions would be effective.)

2. Analysis from the conventional perspective

The conventional perspective of IG starts with the role of economic growth. National income is reflected in national production, and comprises contributions in terms of capital and labour by the agricultural, industrial/manufacturing and services sectors. When economic growth leads to economic benefits, equal employment opportunities lead to a broad-based distribution of the effect of growth, resulting in poverty and income inequality reduction. This conventional framework is illustrated in figure 2, in which the left-hand label, “economic and social policies at the macro and micro levels”, are factors leading to economic growth. The centre label, “employment opportunities”, assumes that the quantity of labour in the labour market provides equal opportunity for employment, which leads to a broad-based distribution of growth effects. It is assumed that persons who are given such opportunity will equally respond to it. This will result in broad-based economic growth, which will lead to the final output of a reduction of “poverty/income inequality”.

However, in this integrating world, productive labour opportunities have expanded with international labour mobility for greater employment opportunities. Therefore, the above conventional framework and analysis has been amended by incorporating foreign employment and the resulting flow of international remittances (Adams, 1991; Adams and Page, 2005; Barajas and others, 2009). The above framework is amended whereby the “employment opportunities” also include foreign labour employment opportunities; thus the labour market is expanded from being mainly focused on the domestic labour market to now including the foreign labour market. When labour is employed internationally, their saving is sent to the home country as remittance flows and is reflected in the balance of payments statistics. This flow of remittance supplements household income and leads to greater national income, which subsequently results in a reduction in “poverty/income inequality”.

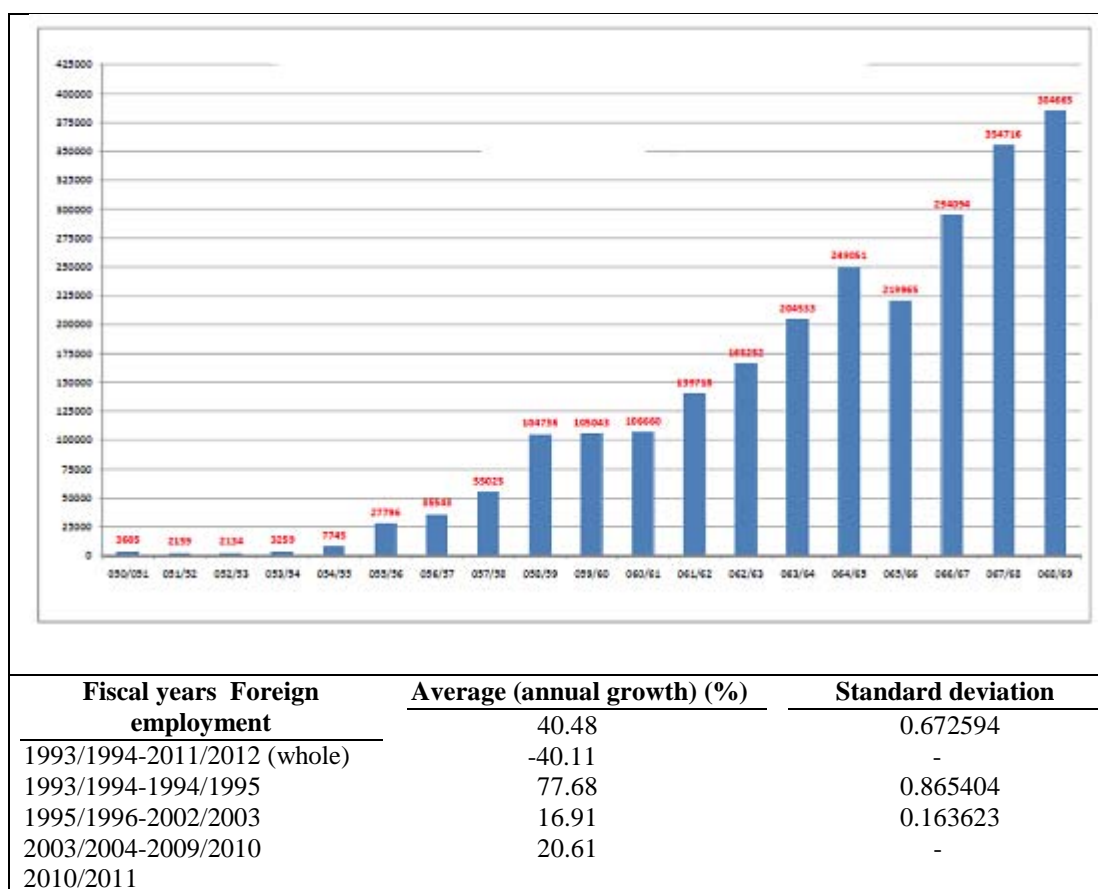
Figure 2. Conventional perspective of IG



Source: Authors' representation.

This framework fits the Nepal case and is reflected in the acceleration in foreign employment, given that there were greater foreign employment opportunities. On first impression, the motivation for foreign employment appears to be based on higher incentives. However, the period of domestic insurgency has to be taken into account; thus, the timing of the growth in foreign employment suggests that there was an additional motivation factors – the contraction of the domestic labour market as well as growing uncertainty and fear. The foreign labour flow of Nepalese nationals is shown in figure 3.

Figure 3. Summary of foreign employment, 1993/1994-2011/2012



Source: Ministry of Labour and Employment, Department of Foreign Employment.

Note: The numbers in the horizontal level are fiscal years where 050/051 represents 1993/94 sequentially up to 068/069, which represents 2011/12.

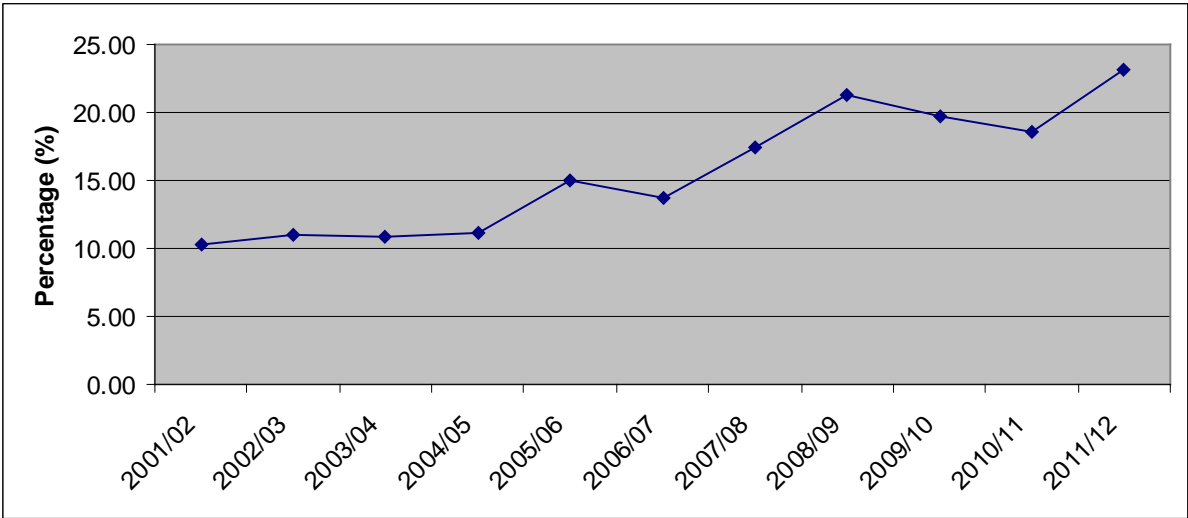
Table 3 appears to suggest that foreign employment only accelerated during the past decade. However, this is misleading since Nepalese foreign employment has been occurring since ancient times. The above figures are misleading due to data collection requirements; employment in countries other than India requires the approval of the Government of Nepal, and is explicitly and officially recorded. However, taking up employment to India requires no such approval (this freedom to work in India is provided by the 1950 Treaty of Trade and Friendship, which also reflects the reality of closely-shared historical and cultural ties), and is thus not recorded in detail. Because of this feature in the methodology of foreign employment reporting, figure 3 is unable to capture the number of Nepalese working in India.³ However,

³ The number of Nepalese working in India is potentially much higher than represented in the official statistics (for a discussion in this regard see Nepal Rastra Bank, 2009). It is therefore important to keep this data limitation in mind.

assuming that employment in India is stable, interpretation of figure 3 is possible. That is, prior to 1997/1998 government statistics on foreign employment showed a stagnant growth rate; however, subsequent to 1997/1998, double digit growth occurred in the full years for which data are available. Nonetheless, while the above data on foreign employment may be underestimated, this has had little effect on the growth rate, which suggests an accelerated rate of Nepalese working in countries other than India (a fact that is also consistent with reality).

Based on the above data regarding increasing labour mobility to countries other than India, there has been a commensurate increase in remittance flows (in general, the greater the number of Nepalese engaged in foreign employment, the greater the volume of the money sent back to Nepal) (MoF, 2012). In this regard, figures for the trend in annual remittances based on the fifth manual of balance of payments statistics are provided in figure 4. Balance of payments statistics, using the form from the fifth manual, were compiled only from 2001/02. Balance of payments statistics based on earlier statistical methods were started in 1975; however, there was no specific heading for remittances. This is shown from 2001/02 in figure 4.

Figure 4. Remittance trend/GDP ratio



Source: Government of Nepal (various issues) and Nepal Rastra Bank.

The magnitude of remittance inflows since 2001/02 reached about 23% of GDP in 2011/2012. Given that there has been stable GDP growth, averaging about 4.25% annually, this suggests that remittances have supported the Nepalese economy and protected it from the contractionary effect of the domestic insurgency. Evidence in this regard is provided by the three NLSS on the receipt of remittances and is provided for comparison, in the below table:

Table 3. Summary of remittance and transfer statistics

SN	Subject	Surveys		
		NLSS I	NLSS II	NLSS III
1	Percentage of households receiving remittances.	23.4	31.9	55.8
2	Nominal average amount of remittance per recipient household (NRs.).	15 160	34 698	80 436
3	Percentage share of remittances in total household income among recipients.	26.6	35.4	30.9

Source: Nepal Living Standard Surveys I, II and III conducted by the Central Bureau of Statistics during 1995-1996, 2003-2004 and 2011-2012, respectively.

For policymakers in Nepal, the role of remittances helps explain the reduction in poverty statistics. However, the relationship of remittances to poverty does not end there as the use of remittances income is also an issue to be explored. This information is shown in the most recent NLSS, which is provided in table 4.

Table 4. Primary use of remittances

Daily consumption	Education	Capital formation	Business	Household property	Savings	Repayment loan	Other	Total
78.9	3.5	2.4	0.5	4.5	0.6	7.1	2.5	100

Source: Nepal Living Standard Survey III, table 15.7, p.86, conducted by the Central Bureau of Statistics, 2011-2012.

Table 3 shows that receipt of remittances income is broad-based with more than 55% of households receiving remittances, suggesting that a wide spectrum of Nepalese have taken up foreign employment opportunities that support inclusive growth. However, data on the utilization of remittances are of concern since table 4 suggests that such remittances are largely used for purchasing consumption goods (78.9%) without capital formation (only 2.4%) – i.e., consumption is more for short-term rather than long-term purposes. This may be because households that have supplied labour for foreign employment are not wealthy; therefore, remittance income is a priority for consumption while investment is given the lowest priority (Combes and Ebeke, 2011; Adams and Cuenca, 2010). Foreign labourers with long-term employment contracts actually exhibit a higher propensity to invest than do their short-term employment contract counterparts (Giuliano and Ruiz-Arranz, 2009; Gupta and others, 2009). It is therefore assumed that emigrant remittances play the same role in economic development as foreign direct investment and other capital inflows; however, remittances by their nature, are not profit-driven but are compensatory transfers that have a generally negative correlation with GDP growth (Barajas and others, 2009; Chami and others, 2003); in Nepal during 2002/03-2011/12 there was a 0.30 coefficient of correlation, which is

statistically insignificant. Nonetheless, while IG is taking place in the country, its consumption-based nature suggests that it is only of a “short-term” nature.

Based on the above analysis, three major recommendations are given for Nepalese policy makers:

- (a) Nepal Rastra Bank and the Central Bank of Nepal – enhance the formal channel of remittances; a step that in this regard would be in line with Pant (2011);
- (b) Government of Nepal and Nepal Rastra Bank – guide the productive use of remittances in order to ensure that the observed IG is not long term in nature (for example, to facilitate channelling remittances into capital formation), which would also be in line with Pant (2011);
- (c) Government of Nepal – makes the economic environment conducive to the productive use of remittances (i.e., maintain a reasonable level of economic stability through building consensus among the political parties on minimum common economic agenda for development).

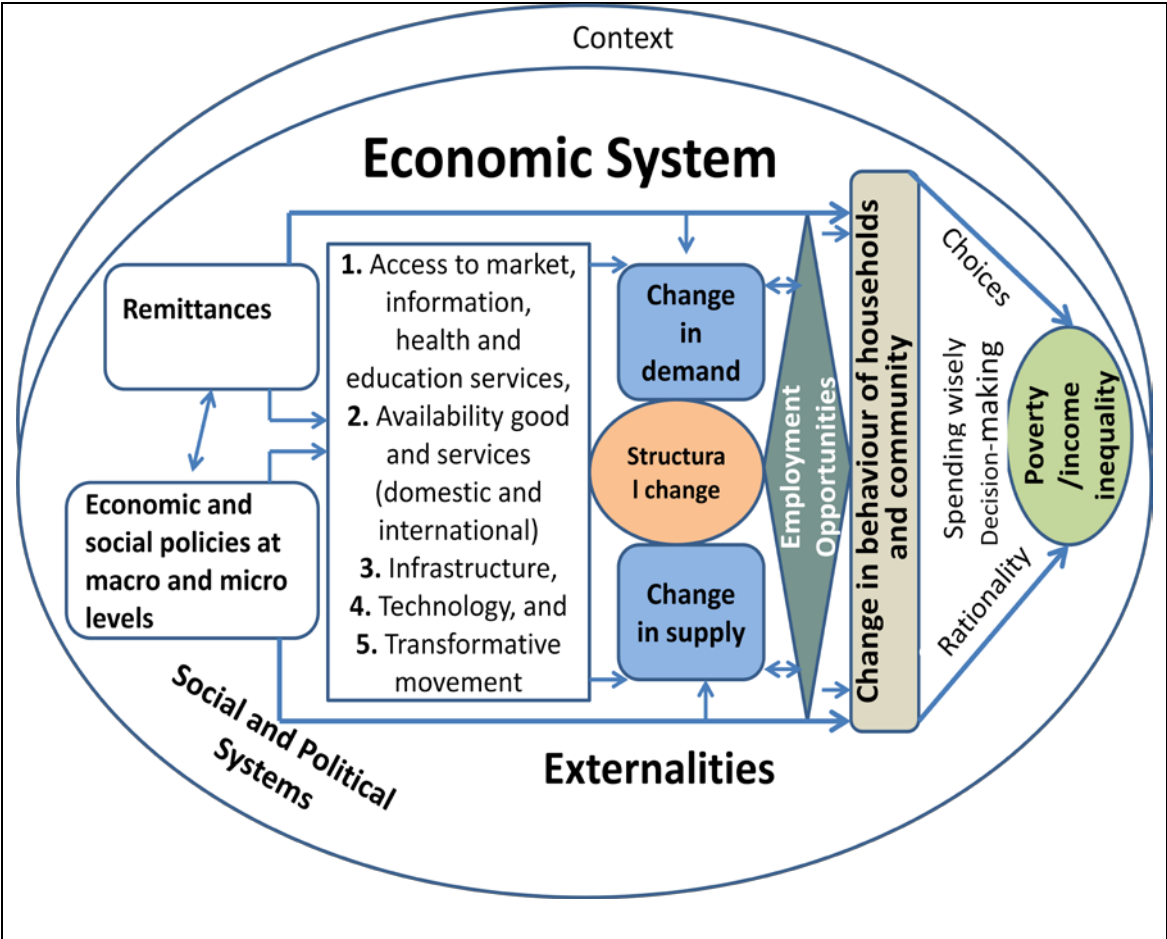
3. Analysis from a holistic perspective

The above conventional analysis is fine at the initial level; however, it is narrow and does not capture the whole picture – it does not provide for an accurate diagnosis of the situation. There is thus a need to broaden the view to the whole economic system using a holistic perspective; this is already occurring in health research as initially suggested by the World Health Organization (WHO) in its 2007 report and has been most recently applied by Bigdeli and others (2012) for a better understanding of access to medicine.

Based on this way of thinking, the conventional framework in figure 2 is broadened to capture interactions from the economic system; this is described as a holistic perspective. That is, the economic system includes interactions of microeconomic and macroeconomic behaviour, demand and supply interactions, activities of the Government, firms and households, and domestic and international market connections. In the conventional perspective, the framework starts linearly from the left-hand side, “economic and social policies at macro and micro levels” and ends with poverty reduction; however, from this narrow perspective the differences start.

The main difference is that the interpretation of the impulses of economic activity are now enriched by the economic system, which is based on “access to market, information, health and education service, availability of goods and service (domestic and international), infrastructure, technology and transformative movement” and those are generally considered unintended consequences. All these factors affect supply and demand, and lead to “structural changes” and affect “employment opportunities”. They also lead to externalities that, in turn, lead to changes “in behaviour of household and community” and are reflected in change in society. All these contribute to reduction in “poverty/income inequality”. This broad framework is shown in figure 5.

Figure 5. Holistic perspective of IG



Source: Authors’ representation.

The above facts and figures of the conventional perspective are still the same and can be used as the basis for the underlying analysis, which can be considered as leading to a direct and intended consequence. However, the priority of the analysis changes when it is broadened in a

holistic manner to now include economic system effects (with some unintended consequences).

From this broader analysis, one unintended consequence resulting from foreign employment was the impetus given to the ongoing dramatic changes in economic and social activities in the rural areas on Nepal. That is, the invigoration by government and international/non-government organizations of rural society through participation, awareness, changing in expectations, information and counselling. There were also social protection policies such as those concerning free health care, free education and allowances for elderly/disabled people that were financed by block grants to local bodies. This was magnified by the positive externality resulting in improvement of accessibility for all types of facilities, which gave people in the rural areas the ability to understand the differences and discrimination despite being illiterate; this then raised expectations among the working-class population. There were improvements in the access to public services for households in rural areas that received remittances vis-à-vis those who did not receive remittances. For example, 95% of households in Nepal are now within 30 minutes of access to the nearest primary school while almost 63% of households have access to health facilities within 30 minutes. Other market-related access to facilities significantly improved during the past 15 years, as described in table 5.

Table 5. Access to market facilities

Facility	(Unit: Per cent)		
	NLSS I	NLSS II	NLSS III
Bus stop	33.1	53.0	66.2
Vehicle passable road	58.0	67.6	79.8
Haat bazaar	41.4	60.7	64.0
Market center	24.2	34.4	44.7
Agricultural centre	24.5	31.9	42.8
Sajha/cooperatives	25.9	33.7	53.9
Bank	20.7	27.8	39.9

Source: Nepal Living Standard Surveys I, II and III conducted by the Central Bureau of Statistics during 1995-1996, 2003-2004 and 2011-2012, respectively.

This, in addition to foreign employment, contributed to the unforeseen consequence of societal changes in Nepal, which resulted in changes in community behaviour. A salient example is the empowerment of women in the rural areas. In a nationally representative survey of married women, more than half of currently married women who earned cash said

that they themselves mainly decided on how their cash earnings were used; two in every five indicated that the decision was made jointly with their husbands (who were generally in either domestic or foreign employment), and only 5% said that the decision was made mainly by their husbands (Ministry of Health and Population, 2011). Similarly, the proportion of surveyed married women who earned cash for their work and who solely decided on the use of their earnings, increased from 31% in 2006 to 53% in 2011. Almost one in four women with cash earnings in Nepal earned about the same as, or more than, their husbands. Almost 25% of the women have made purchasing decisions for their households and almost 30% of such decisions were made jointly with their husbands (Ministry of Health and Population, 2011; Pedraza, 1991).

It is now recognized that gender equality and female empowerment are central to improvements in standards of living and well-being (World Development Report, 2011). Further, the empowerment of women in the rural economy has led to drastic changes – such as choices, rationality, spending wisely, information, externalities and demonstration effects (motivating working or earning income that did not go outside the country), changes in the consumption patterns – jointly contributed to the reduction of poverty. Thus, an unforeseen consequence of foreign employment of Nepalese labour is that it has boosted societal changes, such as the empowerment of women.

There has also been an unforeseen consequence in the domestic labour market, due to the outflow of domestic labour for foreign employment. This is resulting in changes in the composition of labour supply, with the structural changes in wage employment shown in table 6. The share of agricultural wage employment (table 6) has been sharply reduced; however, the daily wage rate in the agriculture sector increased by 88% in 2004 while in the non-agriculture sector it increased by 80%. In 2011, the agriculture wage rate more than doubled (i.e., 127%) while the wage rate in the non-agriculture sector grew by 98%, due to the tightening situation in the domestic labour market (agriculture and non-agriculture). However, the higher rate of the wage increase in the agricultural sector led to structural change and provided choices in terms of increasing employment opportunities, particularly for the low-income group in the agriculture sector. An increase in the wage rate may therefore form a pivot element for rural dynamics (i.e., improvement in income distribution, choices and rational behaviour) (Brown, Connell and Eliana, 2013; Housen, Hopkins and Earnest, 2012). These statistics are shown in table 6.

Table 6. Summary statistics of wage employment

Description	NLSS I	NLSS II	NLSS III
Share of agriculture sector in wage employment (%)	53	37	35
Share of non-agriculture sector in wage employment (%)	47	63	65
Mode of payment (%)			
Daily payment in agriculture	98	88	97
Daily payment in non-agriculture	65	47	50
Mean daily wage (at nominal price) (NRs.)			
Agriculture ^a	40	75	170
Non-agriculture ^b	74	133	263

Source Nepal Living Standard Surveys I, II and III conducted by the Central Bureau of Statistics during 1995-1996, 2003-2004 and 2011-2012, respectively.

^a Real wage rate at NLSS I prices for the agriculture sector; it was NRs. 50 for NLSS II and NRs. 66 for NLSS III, which represented an increase of 25% and 32%, respectively.

^b Real wage rate at NLSS I prices for the non-agriculture sector; it was NRs. 88 for NLSS II and NRs. 103 for NLSS III, which represented an increase of 18% and 17%, respectively.

While table 7 not only reiterates the evidence that structural changes occurred, it also emphasizes the fact that the changes were broad-based – i.e., not only for the persons in the top quintile but also for persons in the lowest quintile as well.

Table 7. Agriculture wage and non agriculture wage by consumption quintile

Consumption quintile	NLSS II		NLSS III	
	Wage in agriculture	Wage in non-agriculture	Wage in agriculture	Wage in non-agriculture
Poorest	67.8	32.2	49.1	50.9
Second	50.9	49.2	46.0	54.0
Third	37.9	62.1	36.2	63.8
Fourth	25.8	74.2	29.9	70.1
Richest	3.4	96.6	6.1	93.9

Source: Nepal Living Standard Surveys II and III conducted by the Central Bureau of Statistics during 2003-2004 and 2011-2012, respectively.

Table 8 shows the increasing trend in household enterprises in Nepal, reflecting a development process that started in 1990s and which encouraged involvement of the private sector. This may be classified as either a foreseen or an unforeseen consequence.

Table 8. Percentage share of household enterprises

Description	NLSS I	NLSS II	NLSS III
Percentage of sample households with enterprises	24.2	28.2	34.6

Source: Nepal Living Standard Surveys conducted by the Central Bureau of Statistics during 1995-1996, 2003-2004 and 2011-2012, respectively.

Table 9 shows that incomes of household from non-farm (i.e., a proxy of the non-agricultural sector) activities and remittances have increased. However, the amount of income from these sources should be carefully compared since household remittance income is the net average income; thus the cost of obtaining foreign employment has not been deducted. The average gross household revenue is higher than the remittance income of those households. Non-farm activities require a continuous and uninterrupted stream of expenditure; however, the cost of obtaining foreign employment is only a one-time cost. Therefore, the direct comparison of average gross income from non-farm activities and the average household remittance income can be misleading. At the same time, expenditures for non-farm activities imply the creation of employment in Nepal. In contrast to remittance income, which has limited backward and forward linkages as well as limited positive externalities, non-farm activities have both forward and backward linkages as well as greater positive externalities in Nepal. Remittance income is thus described as being a short-term phenomenon in contrast to non-farm activities, which are considered a long-term phenomenon.

Table 9. Comparison of income from non-farm activities and remittance income of household by consumption quintile

Consumption quintile	NLSS II (in NRs.)			NLSS III (in NRs.)		
	Average gross revenue of households	Average net revenue of households	Average remittance of households	Average gross revenue of households	Average net revenue of households	Average remittance of households
Poorest	22 102	9 436	13 906	59 293	29 892	34 425
Second	50 603	16 867	21 820	81 047	32 063	45 075
Third	68 651	12 243	24 225	139 602	48 168	60 889
Fourth	108 564	27 102	31 683	343 946	148 602	78 833
Richest	782 874	111 327	65 514	1 045 504	229 164	143 183

Source: Nepal Living Standard Surveys II and III conducted by the, Central Bureau of Statistics during 2003-2004 and 2011-2012 respectively.

All these factors, both foreseen and unintended, have contributed to poverty alleviation in Nepal, i.e., foreign employment contributed to social transformation, which had a positive externality effect and facilitated access to services (Levitt, 1998; Tiemoko, 2004).

It is also important to note that remittances alone to Nepal are not able to reduce poverty levels. This is suggested by table 10, which shows the ratio between remittance income and poverty line income. The ratios are quite low for the fifth and fourth quintiles, although they

have shown rising trends. In fact, the capacity of remittances to raise below poverty line income to at least poverty line income remains lower compared to internal sources of income.

Table 10. Average per capita income from remittances and poverty line income by consumption quintile

Consumption quintile	Average per capita income from remittances			
	NLSS II (in NRs.)	Per cent of poverty line income	NLSS III (in NRs.)	Per cent of poverty line income
Poorest	590	7.7	2 630	13.7
Second	969	12.6	4 286	22.3
Third	1 445	18.8	7 112	36.9
Fourth	2 560	33.3	10 783	56.0
Richest	4 938	64.2	21 433	111.3

Source: Nepal Living Standard Surveys II and III conducted by the Central Bureau of Statistics during 2003-2004 and 2011-2012, respectively.

Note: Average poverty line income for 2003/04 and 2010/11 was NRs. 7,696 and NRs. 19,261 per year, respectively.

This information suggests that poverty levels have been reduced through the interaction between remittances and socio-economic indicators in the economic system. It creates the vibration in the economic system both at the macro- and the micro-levels; however, the case of Nepal suggests that the micro-level has greater power to reduce poverty and income inequality than the macro-level because of the low level of economic growth. Similarly, the improved performance of the health and education indicators has played a positive role in reducing the level of poverty (Ministry of Health and Population, 2011), because the assumption is that if these indicators do not improve, poverty will increase (e.g., bad health has a negative impact on impoverishment).

The above analysis does not detract from the conventional analysis – it strengthens the conclusion. Previously, remittances played a primary role; however, the above system analysis suggests that other significant and unintended consequences of foreign employment have been contributing factors to this phenomenon, i.e., societal changes, boosted by greater access to essential services (Brown and others, 2013). While remittances have been a significant contributing factor, looking at the whole system suggests that other factors have been involved (as suggested by authors such as Khatiwada, 2013). That is, a holistic approach is needed in order to achieve a comprehensive diagnosis and formulate policies for alleviating poverty – an analysis of the IG process of growth through a holistic perspective by examining employment opportunities together with developments in access to services such as education, finance, health care, markets etc., and social changes that internalize externalities in

measuring growth. In this regard, the following recommendations need to be given priority by Nepalese policymakers:

- (a) Roles of Nepal Rastra Bank for the policy – this is similar to that from the conventional analysis which is to continue enhancing the formal channel of remittances (Pant, 2011);
- (b) Jointly roles of the Government of Nepal and Nepal Rastra Bank for policy designing– this is similar to that from the conventional analysis which is to guide the productive use of remittances in order to ensure that the observed IG is long-term instead of short-term, as well as to observe changing tastes and perhaps channel funds to non-farm activities;
- (c) Roles of the Government of Nepal – this is similar to that from the conventional analysis which is to create an environment that is conducive to the productive use of remittances while increasing investment in infrastructure in order to enhance access to facilities that will support and continue the given programmes such as education that will boost societal changes and enhance non-farm activities.

However, as mentioned above, the priorities of these recommendations have changed. Previously the priority was given to Nepal Rastra Bank – i.e., (a), (b) and (c); however, the priority has been reversed to the Government of Nepal (i.e., (c), (b) and (a)).

4. Summary, insight and closing comments

This paper begins with a discussion of IG experiences in general and the paradoxical stylized facts of the Nepalese situation – reducing poverty levels despite a costly domestic insurgency situation that contributed to high uncertainty. This situation is then analysed from both a conventional perspective and a holistic and broader system perspective. While the basic thrust of the analysis on IG has not changed, i.e., the role of remittances in poverty reduction, understanding of the situation (the diagnosis) has changed, which has also affected the policy recommendations. In contrast to the conventional perspective, the recommendations for analysis using a holistic perspective focused more on access and measures to guide societal development (Faist 2008; Housen and others, 2012). As a result, the ordering and priority of recommendations have changed (they are now in reverse order). This case study of the paradoxical Nepal situation thus highlights the fact that a thorough understanding of the interaction and causalities is required in order to provide an accurate diagnosis of the IG process. In addition, it provides a cautionary note that Nepalese (and other policymakers) should exercise care when formulating policy prescriptions.

In closing, two comments are put forward. First on developing a counterfactual – i.e., what would the situation have been in the absence of domestic insurgency? Given that growth rates remained stable within the 4%-5% range during that period, it may be that an absence of domestic insurgency would have resulted in the growth rate increasing, perhaps even doubling. However, the domestic insurgency can be described as providing the motivating force in enhancing access to basic services; given the absence of domestic insurgency, this situation may either not have occurred or may have taken place in a different way. Thus, it can be considered as a critical factor in bringing about the societal changes.

The second comment is that output from this holistic perspective for IG is still a work in progress. The analysis can continually respond to questions of “why” and “how”; with every answer that comes out of the IG process it further decomposes the causal story. Therefore, the IG process from a holistic perspective should not be viewed as a conclusive and finished work, but rather a working hypothesis that is to be continuously probed, challenged and extended by analysts and subsequent researchers. Thus, it is important to recognize that IG is continuously evolving.

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