

Inclusive Growth in Nepal

by

Magnus Hatlebakk*

CMI, Bergen, Norway

magnus.hatlebakk@cmi.no

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Executive Summary

Nepal has had a good economic growth since the mid 80s and throughout the 90s. This has led to increased inequality, but in general the poor have also benefited economically. The exception is some ethnic groups of the central and eastern hills, where labor migration has been more limited. Poverty was still high in 2003 in particular within the Tamang and Rai communities. Poverty has declined among hill Dalits, and probably also among terai Dalits, which can be explained by labor migration to India. However, poverty rates are still high among the Dalits.

The main pathways out of poverty from 1995 to 2003 have been landless farm workers who became subsistence farmers, construction or manufacturing workers, and subsistence farmers who added to their income by working in the same trades of construction and manufacturing industries, or as migrants to India.

Can more households follow the same pathways out of poverty? This depends on the economic policy of the new government. As argued by some Nepali scholars the social democratic model is likely to be followed by the new government. A combination of a social security net with competitive markets and secure property rights, may foster domestic and foreign investments in productive physical and human capital. The role of the government will be to broaden the tax base, and spend the tax incomes, as well as foreign aid, on public goods in support of the combined goal of social security and economic growth. This implies investments in roads, transmission lines for electricity, irrigation, as well as primary education and subsidized health services. Nepal may also consider to copy the rural employment guarantee of India. With a sound social and economic policy Nepal may in general be able to copy the developments of the most successful states of India, with a combination of the policies of Kerala and Punjab, where Kerala focused early on the social sectors, while Punjab focused on agriculture.

With a successful economic policy we expect the poor to be employed in a more productive agricultural sector, including livestock and high value products, as well as in a growing manufacturing sector, while the brick and construction industries may become less important. There are indications that also Dalits take part in these positive developments in the semi-urban areas. However, in the remote parts of terai there are still landless people who work as permanent laborers for the landlords. These people can be helped by moderate land redistribution schemes, which will provide them with a better bargaining position towards the landlords.

Are there some sectors that are more likely to grow in the future, and at the same time benefit the poor and excluded? This combined question is discussed in the periodic development plans of Nepal, as well as by the donors, and some sectors are mentioned. That is, hydropower, tourism, high value agricultural products, and more recently the mobile phone industry, including mobile banking, as well as labor migration. Most of these industries will obviously grow. Large scale labor migration is likely to continue, demand for high value agricultural products, including milk and meat, is likely to increase, even more people will use mobile phones, and hydropower may turn out to be sufficiently profitable for foreign firms to invest the necessary capital.

However, this does not mean that the government, or donors, have a role to play. In most cases the private sector is in the best position to judge profitability. The government may play a role, in cases of market imperfections. We have already mentioned public goods, such as infrastructure, as well as primary education and subsidized health care. When it comes to specific industries, the government may play a role in supporting targeted training programs among excluded groups, for example in production and marketing of new products, or skill training for example as drivers, tailors or masons.

To sum up, a number of policy interventions may support an inclusive growth process. Education and training programs leads to improved human capital. Subsidized health services insure people against major risks, which, in turn, allow them to make profitable investments rather than investments that make them able to handle different types of risk. Investments in physical capital, like transmission lines, roads and irrigation is necessary for economic growth, and a broad-based tax system is necessary to finance these and other costs. Finally, some targeted programs may be beneficiary, such as land redistribution to landless Dalits in remote villages of terai, and experiments with a rural employment guarantee in the same areas.

1. Introduction

Nepal has had a good economic growth since the mid 80s, but with a slightly declining growth trend, as illustrated in Figure 1.

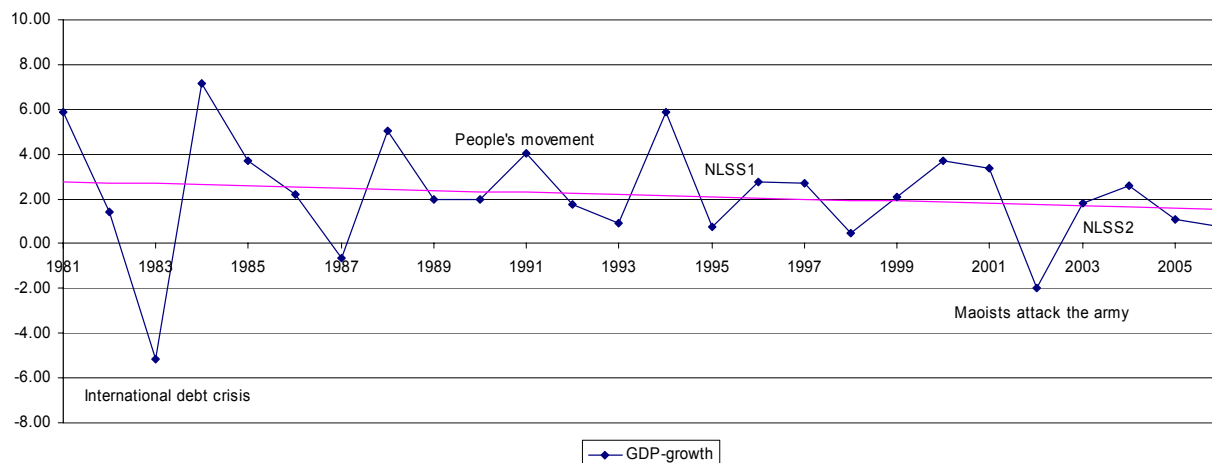


Figure 1. GDP (per capita constant 2005 PPP USD) growth rates, from WDI (2008).

Although the trend growth rate is declining, we note that there has been a good growth throughout the period of civil war from 1996 to 2006, which is illustrated by the GDP-figures in Figure 2, which constitute the basis for the growth rates in Figure 1. Note that we use constant per capita GDP figures, so this is real domestic economic growth.

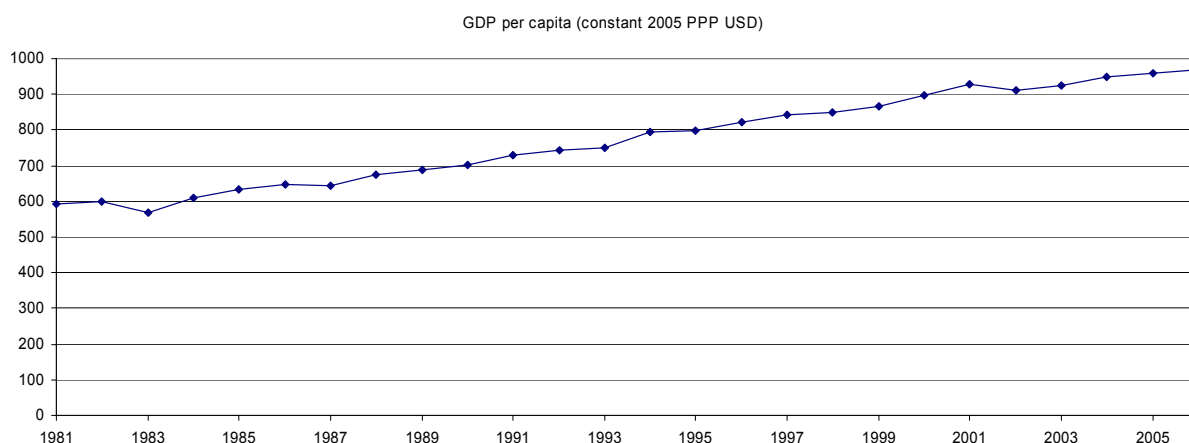


Figure 2. GDP (per capita constant 2005 PPP USD), from WDI (2008).

Figure 2 illustrates that incomes gradually increase despite a low growth in some years. The growth rate has been on average 2% per year, with the exception of the recession in 2002 that followed the escalation of the war in November 2001, when the Maoists attacked the army for the first time. Furthermore, in addition to the increase in domestic production there has been

an increase in remittances from labor migration, which also add to household incomes. Together these improvements can explain the decline in poverty, as reported in NLSS (2005), from 42% in 1995 to 31% in 2003.

With the exception of the rural eastern hills, there has been a good growth in incomes for basically all groups, including the poor. Inequality has increased, in the sense that the rich have had a very high income growth (6.4% per year for the richest 20%, as compared to 3.7% for the next quintile, and 2.5% for the lowest 20%), see NLSS (2005). An almost doubling of the income of the wealthy during the last decade is noticeable for all who have visited Nepal during these years. Compared to the mid 90s, the middle class of Nepal can now afford vehicles, electronics, restaurant meals, and other consumer goods and services, as well as improved housing and education for their children. But also the poor have improved their living standards, a 22% increase in real incomes between 1995 and 2003 for the bottom 20% means that they can afford better quality food, as well as durables such as bicycles, radios, and mobiles. We conclude that the economic growth has led to an increase in inequality, but still improved living conditions also for the poor. In section 2 we discuss whether all castes and ethnic groups have benefited, or whether some groups are excluded from the growth process.

2. Social and economic exclusion in Nepal

The Nepal Living Standards Survey (NLSS) is the best household level data we have from Nepal. The survey has been conducted twice, in 1995/96 and 2003/04. The poverty estimates are also the best available for Nepal. Table 1 reports poverty rates for different castes and ethnic groups in the two rounds of NLSS¹. Note that the estimates are based on reported expenditure of the households, and not the less reliable reports of income sources. This means that expenditures that are based on remittances from labor migrants are also included.

The poverty line used by NLSS is set to the rupees per person a normal household will need to buy a normal basket of food that contains 2124 kcal per day, plus normal additional spending for a poor household. The poverty line varies between regions depending on local prices, and was rupees 11 000 per person per year in Kathmandu for the survey period 2003/04, see Table 2.3.1 in NLSS (2005). For a six-person household this means 5 500 rupees

¹ A similar, but not as detailed, table is found as Table 1.4.5 in NLSS (2005). In particular we report confidence intervals and significance tests. Arun Das (2008) is presently writing a more detailed report on social and economic indicators for different castes and ethnic groups, using the same data sets.

per month. In rural Eastern Terai the poverty line is 6 000 rupees, which for a six-person household means 3 000 rupees per month. A normal wage in Kathmandu for casual workers is in the range of 100-200 rupees, and in rural Terai it is in the range of 50-120 rupees. As casual laborers do not work every day, a poor household will thus need at least two working members who are employed large parts of the year to cross the poverty line.

Table 1. Poverty rates based on necessary expenditure to meet calorie requirements

Caste/ethnic group	Poverty rate 1995-96	N	Poverty rate 2003-04	N
Hill Brahmin	23.4 (16.9-29.8)	517	10.0 (5.1-15.0)	548
Hill Chettri	44.5* (36.8-52.2)	634	25.7* (19.1-32.4)	622
<u>Hill Janajati:</u>				
Newar	20.7 (10.4-31.1)	300	14.0 (8.3-19.6)	411
Gurung	39.3 (18.7-59.9)	126	18.6 (3.6-33.7)	124
Magar	61.3* (48.3-74.2)	161	34.4* (24.9-43.9)	248
Tamang	48.4* (32.5-64.4)	140	61.2* (50.8-71.6)	225
Rai	32.9 (20.9-44.9)	55	48.5* (33.5-63.5)	139
Limbu	32.1 (12.3-52.0)	62	40.5* (26.7-54.4)	64
<u>Hill Dalits:</u>				
Kami	62.7* (52.2-73.3)	154	48.4* (37.3-59.5)	161
Damai	60.1* (44.8-75.5)	56	39.8* (24.6-55.1)	75
Sarki	41.4* (24.9-57.9)	50	45.8* (31.9-59.7)	70
<u>Terai groups:</u>				
Yadav	28.3 (18.9-37.6)	102	21.3 (8.9-33.8)	83
Tharu	53.4* (42.2-64.5)	184	35.4* (23.7-47.2)	188
Muslim (mostly terai)	44.3* (33.6-55.0)	124	41.3* (31.3-51.4)	168
Teli			7.7 (0-16.4)	40
<u>Terai Dalits:</u>				
Chamar			50.9* (35.3-66.5)	47
Musahar			53.4* (31.8-74.9)	30
Others (mostly terai)	45.9* (38.6-53.2)	543		
Nepal	41.8 (38.1-45.4)	3373	30.8 (27.8-33.9)	3912

Compiled by the author. 95%-confidence interval in parentheses.

* Significantly different from hill-Brahmins at the 95%-level.

Bold means significant decline at the 90%-level.

As we may expect, hill Brahmins have the lowest poverty rates both in 1995 and 2003. The highest poverty rates in 1995 are found among the Magars, some hill Dalits and the Tharus. In 2003 the Tamangs have a very high poverty rate. Other groups with relatively high poverty rates in 2003 are the Rai people of the eastern hills, some hill-Dalits, and the terai Dalits. The terai Dalits were included in the residual "others" category in 1995. From 1995 to 2003 poverty has declined among the hill Brahmins and Chettris, as well as among the groups that had the highest poverty rates in 1995, the Magars, some hill-Dalits, and the Tharus.

The high poverty rates among the Tamang and Rai people of the eastern hills are reflected in the high average poverty rate of the eastern hills as reported in (Table 1.2.2. of) NLSS (2005). The eastern hills of Nepal is the only part of the country where the poverty rate increased from 1995 to 2003. This supports the conclusion that labor migration is a main explanation for the decline in poverty. According to Gurung (2008) migration is at the lowest in the eastern hills, and if they migrate they tend to migrate within Nepal. In the western hills, on the other hand, a large majority migrate to India. The high level of labor migration to India from the western hills may explain the reduction in poverty in this region.

When it comes to the Dalits, we find that, despite a reduction in poverty rates, the hill-Dalits are still lagging behind. We do not have an estimate for the poverty rate among the terai Dalits in 1995, but they are among the poorest also in 2003. Still we note that the level of poverty is in the same range as for the hill Dalits. This contrasts with, in particular, the literacy rates that are very low among the terai Dalits (only 8% can read and write in the Musahar community). Based on our experiences from the field, we believe that the poverty rates among the terai Dalits were even higher in 1995. As education takes time, poverty in the past may explain the low literacy rates. At the same time it is our impression that terai Dalits have traditionally faced even stronger discrimination than the hill Dalits, including in the schools, which may also explain the low literacy rates. In the future we may expect that improvements in the economic conditions for the terai Dalits will lead to improvements also in the social indicators.

We conclude that there is a strong link between social exclusion, as defined by the caste-hierarchy, and economic poverty. Even in 2003, the hill and terai Dalits, as well as the hill Janajatis of the central and eastern hills, are the poorest. There have been some improvements since 1995 as poverty has declined among the poorest groups. These groups have probably been able to move into more profitable occupations. We will discuss these changes in occupation in more detail in the next section. We note that many groups are lacking behind, in particular some hill Janajatis (Tamang, Rai), hill Dalits (Kami, Sarki) and

terai Dalits (Musahar, Chamar). Among these groups there have been improvements since 1995 for the hill Dalits, and probably for the terai Dalits, while the hill Janajatis of the central and eastern hills have not seen any improvement. The different developments for these groups can be explained by different regional migration patterns.

3. Pathways out of poverty between 1995 and 2003

In this section we discuss the main pathways out of poverty during the eight years from 1995 to 2003, that is, during the escalation of the civil war. Table 2 is based on Table 1.4.1 in NLSS (2005) and gives poverty rates in 1995 and 2003 for different sectors of employment².

Table 2. Poverty rates by sector of employment of household head

Sectors:	Poverty rate 95-96	Poverty rate 03-04	Distr. of the poor 95-96	Distr. of the poor 03-04	Pop. shares 95-96	Pop. shares 03-04	The poor 95-96	The poor 03-04
Self employed:								
Agriculture	43.1	32.9	60.7	66.9	58.8	62.7	25.3	20.6
Manufacturing	41.4	31.2	3.4	4.5	3.4	4.4	1.4	1.4
Trade	32.2	11.1	4.3	1.6	5.6	4.5	1.8	0.5
Services	25.3	14.4	1.0	1.5	1.6	3.2	0.4	0.5
Wage earner:								
Agriculture	55.9	53.8	15.7	10.9	11.7	6.2	6.5	3.3
Professional	8.3	2.1	0.4	0.2	2.2	2.9	0.2	0.1
Other	39.7	28.8	10.6	10.0	11.1	10.7	4.4	3.1
Unemployed	9.5	2.9	0.1	0.0	0.3	0.2	0.0	0.0
Non-active	30.5	26.9	3.9	4.4	5.3	5.1	1.6	1.4
Nepal	41.8	30.8	100	100	100	100	41.8	30.8

Reproduced from Table 1.4.1 in NLSS (2005)

We will first discuss developments within the agricultural sector, then go on to the non-agricultural sector focusing on wage employment, which is essential for the poor. Finally we discuss the role of foreign employment, before we conclude the discussion of pathways out of poverty.

3.1 Developments in the agricultural sector

Table 2 illustrates that the reduction in poverty from 41.8% in 1995 to 30.8% in 2003 is basically due to two developments. *First*, farm workers were the poorest among the poor in 1995 with a poverty rate of 55.9%, and there are far fewer farm workers in 2003, as we can

² We have added the last two columns where the poverty rates are decomposed according to employment categories (by multiplying the corresponding poverty rate and population share from two other columns).

see from the population share that has declined from 11.7% to 6.2%. It appears that many of them are self employed in agriculture in 2003, as the population share has increased for this group. We believe that this is due to a combination of land rental and land purchases. *Second*, the poverty rate among the self employed farmers has declined. So our first conclusion will be that farmers in Nepal, including farm workers, have left poverty in large numbers. From the underlying data we also know that self employed farmers have higher income than farm laborers, even if they are still below the poverty line. This indicates that those who have switched from farm labor to subsistence farming are better off although they are still poor.

The reduction in poverty among the self-employed farmers can be due to increased demand for agricultural products, or an increase in off-farm income possibilities. We will look into these developments in more detail below. The switch from the use of farm labor to self-employed farming is to some extent due to relatively higher agricultural wages, see Table 3. The higher wages can be explained by a shift in local labor supply that is due to increased labor migration, in combination with a more organized labor force, in particular in Maoist controlled villages. The switch to self-employment is probably also to some extent due to increased supply of land for rent, as landowners have moved to urban areas due to the Maoist insurgency.

Table 3. Agricultural daily wages in rural areas (rupees)

Regions	Nominal 1995-96	Nominal 2003-04	Real 1995-96	Real 2003-04	Increase
Rural-west hill/mount	49	90	49	54	10%
Rural-east hill/mount	37	86	37	54	46%
Rural-west Terai	50	89	50	63	26%
Rural-east Terai	43	61	43	54	26%

Reproduced from Table 1.6.5 in NLSS (2005)

There has been some increase in demand for agricultural products, but there still appears to be a relatively limited effect of farm incomes on poverty rates. In 1995 only 36% of the farmers cultivated summer vegetables, while this share has increased to as much as 61% in 2003, see the NLSS (1996 and 2004) summary reports. This constitutes a 70% increase, which reflects an increased demand for vegetables that is the result of increased incomes among both the rural and, in particular, the urban population. Furthermore NLSS (2005) reports in Table 1.6.3 the change in consumption of different food items. The main finding is an increase in consumption of high quality rice, which is compensated by a reduction in the consumption of maize, but also wheat. So people buy approximately the same amount of grain, but they can now afford higher quality rice. There is also a doubling of chicken consumption, but it is still

at a low level in 2003, with 100 gram per person per month. There is a similar growth in fish consumption, which is also still at a low level with 90 grams per month in 2003. At the same time the number of self-employed farmers has increased and NLSS (2005) reports in Table 1.7.3 that the average farm income has not changed. The reduction in poverty among farmers must thus be explained by an increase in off-farm incomes. In accordance with this we find, from the same Table 1.7.3, that remittances and non-agricultural wage incomes have increased more than many other types of income for the low income groups.

The main conclusion when it comes to the farming sector is thus that some farm laborers have turned into self employed farmers, possibly by renting land, and self employed farmers have left poverty by adding other incomes to their farm incomes. For other sectors of employment reported in Table 2 there has not been much of a change when it comes to poverty rates, and in numbers these sectors are not so important. However, note that we have classified households according to the main employment of the household head, while the off-farm income of a household can be the main employment of some other household members. We will now look into this in more detail, by reporting on the main occupation (measured by the number of days) of all household members, see Tables 4 to 7.

3.2 Non-agricultural wage employment

Tables 4 and 5 report in the two first columns on the main occupation, including agriculture, of all household members. The two next columns report on the main occupation of the household as a whole, measured by the maximum number of days in one occupation for one household member. Tables 6 and 7 report on wage employment outside agriculture, first for all reported occupations among all household members, then for the same main occupation of all household members as reported in Tables 4 and 5. We thus include the main occupation of the household in Tables 4 and 5, but not in Tables 6 and 7. This is because the sample sizes become very small for non-agricultural industries. In contrast to Table 2 we use the original employment categories, rather than combining categories. These categories changed somewhat between 1995 and 2003.

Table 4. Most frequent main occupations, 1995

Occupations	Main occ. memb.		Main occ. hh	
	Poor	Non-poor	Poor	Non-poor
Teachers	0.1	1.2	0.1	2.6
Transport workers	0.3	0.5	1.0	1.7
Working proprietors	1.7	3.2	2.9	5.7
Farmers	42.4	43.4	45.6	50.0
Farm-labor	25.8	14.4	35.3	18.8
Production laborers	1.8	1.6	3.4	3.3
Student	9.8	15.8	0.0	0.3
Not working	11.8	11.8	0.5	1.1
N	4602	8922	1074	2269

Compiled by the author

Table 5. Most frequent main occupations, 2003

Occupations	Main occ. memb.		Main occ. hh	
	Poor	Non-poor	Poor	Non-poor
Shop salesperson	0.6	3.0	1.4	6.6
Animal prod. for market	1.3	1.2	1.4	1.9
Subsist. agr. workers	37.7	33.1	39.9	30.8
Build. frame workers	1.0	1.0	1.7	1.9
Textile workers	0.6	0.6	1.1	1.2
Messengers, porters, etc.	0.8	0.5	1.7	1.3
Garbage collectors	2.9	1.5	2.1	0.2
Agricultural laborers	6.9	2.8	9.8	4.0
Household work	21.3	24.9	29.5	30.2
Student	12.1	16.4	0.0	0.0
Not working	8.9	4.1	0.0	0.0
N	4662	13071	905	3005

Compiled by the author

Tables 4 and 5 reproduce some of the findings from Table 2. For 1995 we note that farm labor is more common among the poor. This is still the case in 2003, but in total there are fewer farm laborers. As discussed, some of the farm laborers have probably turned into subsistence farmers. We conclude that the reduction in poverty between 1995 and 2003 means that many people do no longer have to work as farm laborers as their main occupation. Some of them have become subsistence farmers, which gives a better income, while others do non-agricultural work, as reported in Tables 6 and 7.

Table 6. Most frequent non-agr. industry, wage employment 1995

Occupations	All occ. memb.		Main occ. memb.	
	Poor	Non-poor	Poor	Non-poor
Manuf. food	2.6	2.9	4.0	3.2
Manuf. textile	2.9	4.7	3.8	5.1
Manuf. furnit.	6.0	6.3	5.4	6.1
Manuf. oth. non-metal.	2.0	1.9	1.9	1.7
Manuf. handicr.	3.5	1.1	5.9	1.0
Manufacture-all	18.8	18.8	23.4	19.5
Const. build.	26.9	18.8	21.9	12.0
Const. roads	6.0	2.7	4.4	1.6
Const. pipelines	2.4	2.9	2.7	2.1
Construction-all	36.7	25.4	29.6	17.0
Trade retail	8.4	3.8	7.4	3.6
Restaurant	1.4	1.3	2.7	1.2
Transport	5.2	6.2	6.6	5.8
Publ. adm.	1.7	3.3	2.9	4.8
Social sector	3.7	17.4	4.7	22.3
Household sector	8.7	6.7	10.0	6.3
N	645	1298	306	946

Compiled by the author

Table 7. Most frequent non-agr. industry, wage employment 2003

Occupations	All occ. memb.		Main occ. memb.	
	Poor	Non-poor	Poor	Non-poor
Manuf. food	2.1	3.2	3.7	3.3
Manuf. textile	1.9	4.8	3.6	5.0
Manuf. wearing appr.	1.7	2.7	2.7	2.9
Manuf. wood prod.	5.7	3.3	1.4	2.5
Manuf. oth. non-metal.	2.6	2.9	4.0	2.8
Manuf. fabric. metal	1.1	1.2	2.2	1.5
Manuf. furniture	2.6	1.4	3.2	2.0
Manufacture-all	19.2	24.0	22.8	25.6
Construction	49.9	28.5	40.0	17.4
Retail trade	1.0	2.3	1.2	3.2
Land transport	3.3	4.0	3.8	4.7
Business act.	0.9	2.0	1.1	2.4
Publ. adm.	0.4	3.5	0.4	5.1
Education	3.2	11.5	6.3	15.7
Health and social work	0.4	2.6	0.4	3.1
Service	12.4	6.4	9.9	4.1
Private hh employm.	2.1	1.3	3.0	1.4
N	593	1941	282	1308

Compiled by the author

Wage labor in manufacturing industries has become relatively more important for the non-poor in 2003, as compared to 1995, which indicates that wage employment in manufacturing industries has been one pathway out of poverty. Construction was the main non-agricultural wage employment for the poor in both 1995 and 2003, and in both years more important than for the non-poor. Furthermore, the importance of construction has increased, in 2003 as many

as 50% of all reported jobs were in construction, as compared to 37% in 1995. Since these workers are still poor, one may conclude that construction has not been a pathway out of poverty. However, among the poor, construction workers are better off than farm laborers, and from our fieldwork we know that many landless farm laborers also work in construction. So, although these people stay below the poverty line, they are still better off, and construction can thus be seen as a pathway out of poverty.

Recall that the classification of occupations has changed between the two surveys. So, while retail trade was important in 1995, it is recorded as a less important occupation in 2003, while service has become important in 2003. This change may be due to the reclassification. So while the service sector apparently is popular among the poor according to the 2003 data, retail trade was popular among the poor in 1995. However, as these categories may cover the same occupations, we should not interpret this as a change in occupations among the poor.

To conclude, farm labor has declined and the poor from this sector have become subsistence farmers, manufacturing- and construction workers. In 2003, 50% of the reported non-agricultural jobs are in construction, and another 19% are in manufacturing industries. While many construction workers are still poor, they are better off, in income terms, than farm workers. This is a general trend found in NLSS (2005), those who are still poor in 2003, are relatively less poor than in 1995, as measured by the gap between the poverty line and income levels, which is the standard poverty gap measure of Foster, Greer, Thorbecke (1984).

3.3 Employment abroad

This far we have only focused on domestic employment, but one major explanation for the reduction in poverty from 1995 to 2003 is the increase in labor migration. We have already discussed the indirect effects via local labor markets, but there are also direct effects in terms of remittances. Table 1.7.1 of NLSS (2005) shows that 32% of the population receives remittances in 2003, up from 23% in 1995, and the increase is largest for the poorest households. Table 1.7.3 of NLSS (2005) shows that in 2003 remittances constitute 10% of total incomes in Nepal, in the same range as agricultural wage incomes and incomes from non-agricultural enterprises, but lower than non-agricultural wage incomes, which constitutes 17% of total incomes.

The households that receive remittances are not very different from other households when it comes to the main occupation of the household members. The main difference is that self employed farmers constitute 39% of the non-poor household members in households that

receive remittances, as compared to 32% among non-poor households that do not receive remittances. If we look into all non-agricultural wage employments then manufacturing is less common among poor households with migrants than among poor non-migrant households. For construction there is some evidence of the opposite finding that poor households with migrants have more people employed in construction. We believe that these differences are due to heterogeneity among migrant households, and any causal effects can be two-ways. For example, remittances allow for investments, which may explain that non-poor households with migrant members become self-employed farmers. But on the other hand, a self-employed farmer may be able to raise the necessary credit for labor migration. We now go on to discuss migration patterns for different economic and social groups.

Table 8. Households (%) receiving remittances from abroad in 2003

Groups (N)	Migrant-hh	95%-conf.int.
<u>Poverty status:</u>		
Poor (905)	17.6	(14.2-21.0)
Non-poor (3007)	17.4	(15.2-19.7)
<u>Caste/ethnicity:</u>		
Hill Brahmin (548)	17.5*	(12.2-22.8)
Hill Chettri (622)	21.6*	(16.3-26.8)
<u>Hill Janajati:</u>		
Newar (411)	7.3	(3.0-11.7)
Gurung (124)	24.2*	(14.0-34.4)
Magar (248)	23.2*	(16.7-29.8)
Tamang (225)	7.5	(2.9-12.0)
Rai (139)	13.9	(6.3-21.5)
Limbu (64)	25.3*	(15.7-34.8)
<u>Hill Dalits:</u>		
Kami (161)	29.6*	(21.0-38.2)
Damai (75)	14.9	(6.1-23.7)
Sarki (70)	31.3*	(13.6-49.0)
<u>Terai groups:</u>		
Yadav (83)	20.3*	(9.9-30.7)
Tharu (188)	8.6	(3.9-13.4)
Muslim (168)	22.1*	(13.8-30.4)
Teli (40)	11.0	(0-24.1)
<u>Terai Dalits</u>		
Chamar (47)	11.7	(0-27.1)
Musahar (30)	25.6*	(10.1-41.1)
Nepal	17.5	(15.4-19.5)

Compiled by the author. * Significantly different from Newar at 95% level

Table 8 reports on the household migration status (measured as recipient of remittances) for the poor and the non-poor, as well as for selected castes and ethnic groups, while Table 9 reports on the opposite, that is, the poverty status of households with migrants. For further discussions of these issues see Gurung (2008).

Table 9. Poverty status for households receiving remittances in 2003, in %

Migration status (N)	Poverty (%)	95%-conf.int.
Receiving remittances (643)	31.0	(25.6-36.4)
No remittances (3269)	30.8	(27.6-34.0)
Remittances from:		
India (407)	39.3	(32.7-45.9)
Malaysia (48)	25.5	(8.0-43.0)
Middle-East (124)	14.3*	(5.5-23.0)
Other countries (64)	2.3*	(0-6.8)
Nepal	30.8	(27.8-33.9)

Compiled by the author. 95%-confidence interval in parenthesis

* Significantly different from India at 95% level

Tables 8 and 9 both show that there is no difference in the tendency to migrate between the poor and the non-poor. However, there is a major difference in destination. The poor go to India, the non-poor go to the Middle-East and other countries, while Malaysia is in an intermediate position.

Looking into castes and ethnic groups there are also major differences. The traditional inhabitants of the Kathmandu valley, the Newars, have the lowest migration rate, while hill Brahmin/Chettris, most hill Janajatis (Gurung, Magar and Limbu), most hill Dalits (Kami, Sarki), and some terai groups (Yadav, Muslim, and Musahar) migrate more. As we may expect, these groups select destinations in accordance with their level of poverty. The hill and terai Dalits, as well as the Tharus, go to India for work. In addition, the Yadavs and hill Chettris also go to India. As the Yadavs in many cases have relatives in India this is not surprising, but the relatively high share of Chettris in India is somewhat surprising, but is probably explained by the high share of Chettris in the western hills, where it is popular to go to India for work. For Malaysia there is some indication that Rai/Limbus are overrepresented, for the Middle-East there is some indication that hill Janajatis in general are overrepresented, and for other countries some indication that the Gurungs are overrepresented.

The general conclusion is that the poor and excluded groups, as well as the middle castes from the terai region, go to India for work, while hill Janajatis go to higher status destinations. In India poor people work seasonally in agriculture, but also more permanently in factories, as security guards, and in restaurants. The poor will normally earn more in India than at home, although their household income may still be below the poverty line. The increase in income means that labor migration to some extent is a pathway out of poverty.

3.4 Conclusions on pathways out of poverty

Farm workers were the poorest in 1995, and many of them have left this occupation in 2003. Some of them have become subsistence farmers, while others are employed in construction, factories, as well as in different occupation in India. These are traditional pathways out of poverty in gradually developing economies. In the next section we will discuss the potential for other poor people to follow the same pathways, and also discuss government policies that may support these developments.

4. Can other groups follow the same pathways?

The answer to this question depends on the rate of economic growth, the content of that growth process, meaning what sectors and actors are active, as well as government policies, which in turn may affect the pattern of growth. We split this discussion in two parts. First we discuss the role of general policies for inclusion of excluded groups, then we go on to the potential for continued growth within specific sectors using successful states of India, in particular Punjab, as examples.

As already argued, Nepal has had a good economic growth during the last decades. As in many countries the economic growth has not been equally shared, the incomes have grown faster for the rich than for the poor. Still many have left poverty, and the poor are less poor than before. This is also the case for many socially excluded groups, even landless farm workers from the lowest rung of the caste hierarchy have improved their economic conditions by way of employment in brick industries, better paid farm and industrial work in India, as well as wage employment in local factories.

4.1 General policies for inclusive growth

As illustrated in Figures 1 and 2 of section one Nepal has had a good economic growth despite the civil war. The recent peace may, in theory, pave the way for accelerated economic growth. However, this depends on the economic policy of the new government. The Maoists won the election in April 2008, and will continue to be a major player in the development of Nepal. A sound economic policy is a necessary condition for economic growth and poverty reduction. Investments in physical and human capital are necessary for increased production of goods and services. However, there is a major difference between these two types of assets. While human capital can relatively easily be transferred between countries, physical capital is only to a limited extent transferable. This, in turn, means that investors are less willing to

invest in countries where ownership and profitability are less secure. The rhetoric of the Maoists after the election shows that they are aware of this, as Baburam Bhattarai said in an interview in Kathmandu Post after the election: "From our side, we have to provide security to investors and create a conducive environment for domestic and foreign financiers. And I also think that we will be able to resolve the differences between labor and management. Unless we resolve such issues, we cannot create a better investment atmosphere."

It appears that investments in human capital as well as urban land and housing have had the highest priority during the decades of economic growth. This explains the increased importance of construction work as a pathway out of poverty for the poor, and investments in education may lead to improved economic growth as long as the well educated get good jobs within Nepal. Only firms that do not operate in competitive markets can afford not to hire the best educated people. Within a traditional economy that lacks competition from abroad and from within the country, there is a danger of nepotism in hiring, even in the private sector. It is essential for the new government to demonstrate that they encourage competition and investments, not only to attract physical capital, but also to attract human capital, in particular the young people who have got on the job training and more formal education abroad during the years of conflict. It is also essential to prove that people can return to Nepal without fear of physical and financial harassment. The migrants need to be sure that they can settle in Nepal, invest in businesses, and keep their income except for regular government taxation.

Policies to attract physical- and human-capital are necessary for improved economic growth, but may not be sufficient to radically improve the life for those who are still lacking behind. The government must provide the public goods necessary, not only to promote economic development by way of investment in physical infrastructure and facilitation of domestic and international trade, but also to establish a social security net. A necessary condition will be a broader tax base that can finance a social security net. That is, as the economy grows it is essential that most economic activities contribute to the government budget, which in turn is spent on goods and services that promote an inclusive growth process, and at the same time have a broad support among tax-payers and voters. A social security net will in itself contribute to economic growth as the poor and the middle-class will not have to self-insure by keeping assets, such as land and houses, that are not so productive.

A social security net in a poor country means subsidized, but preferably not free, health care, and may include some sort of income/employment guarantee. In particular for the latter, Nepal should learn from the experiences with the National Rural Employment Guarantee in India, where each household has the right to limited employment for one person.

Land-ownership may also contribute to the security of the very poor in the rural sector. We will discuss these policies in more detail in section 6. Some of these policies imply difficult trade-offs between redistribution to the poor, and lack of incentives for investment and work efforts among the poor as well as the more wealthy. This is a traditional trade-off, which is solved differently in different countries. With the present political situation in Nepal, the social democratic model is most likely the feasible solution, with emphasize on social security nets, which in turn may improve efficiency in some sectors of the economy, but may be counterproductive in other sectors. See Moene and Wallerstein (2006) for a discussion of the social democratic model as a model for economic development³. Within Nepal, the leading sociologist Chaitanya Mishra has recently supported the same model in the local media, see for example Mishra (2008).

4.2 Likely developments in different sectors

In many respects Nepal is the little sister of India. Kathmandu can, in some aspects, be compared to urban areas of India. The hills of Nepal are similar to the hills of Darjeeling, and other hill areas of India, while the terai is similar to the northern states of India. With the high growth rates in India, Nepal can, at best, follow the same path. With a sound social and economic policy it is likely that Nepal will follow the developments we have seen in the successful states of India. We will now go into more detail on these developments.

There are large differences within India, which allows researchers to identify factors that have been important for poverty reduction. Martin Ravallion and Gaurav Datt of the World Bank are at the fore-front of this research, and in particular in Ravallion and Datt (2002) they describe the developments in India, and identify factors important for pro-poor growth. Between 1960 and 1994 poverty has declined at a rate of 2.7% per year in Kerala, 2.5% in Punjab-Hararyana, 2.2% in Andra Pradesh, and 2.0% in West-Bengal, while the reduction in poverty was only 0.6% in Madhya Pradesh, and zero in Assam and Bihar. Ravallion and Datt show that farm yields, development spending, non-farm output, and low inflation all contributed to poverty reduction. In particular growth in non-farm output was more important for poverty reduction in some states than in others. The effect of increases in non-farm output on poverty was higher in states with good initial conditions, that is, states that started out with, in particular, a high literacy rate, but also states with high farm productivity, few landless people, low infant mortality rates, and a high level of rural

³ This is part of a special issue on Equity and development with other articles that may be of interest.

development. Thus in aggregate terms they find that rural economic development is more important for poverty reduction than urban development.

This analysis indicates that agricultural developments, in terms of improved farm yields, rural development including investments in the health and primary education sectors, as well as non-farm economic growth, have to be in place to effectively reduce poverty. This means that there is no short-cut to development, long term investments are necessary and government involvement is essential. The government should invest in primary education and health care, support agricultural development, possibly implement some (weak) land-reforms, and remove barriers to non-farm employment.

In India the non-farm output per person has grown with 4.4% per year in Punjab-Hararyana, 4.2% in Andhra Pradesh, 4.0% in Jammu-Kashmir, and 3.9% in Tamil-Nadu, while it has grown with only 2.0% in Bihar and 2.1% in West-Bengal. However, the effect on poverty varies a lot, with growth in non-farm output having the largest effect on poverty in West-Bengal and Kerala. So, although the growth rate is not so large in West-Bengal, the poverty impact has been better, and the explanation for the success cases of Kerala and West-Bengal, as well as some other states, is the good initial conditions in 1960. Kerala had a female literacy rate at that time of 39%, an infant mortality rate of 7% and an agricultural output of 96 000 rupees per hectare, as compared to the same indicators for Madhya Pradesh of a 7% female literacy rate, a 13% infant mortality rate, and an agricultural output of only 8 000 rupees per hectare. So, despite a good growth rate of 3.3% per year in non-farm output in Madhya Pradesh, poverty has barely declined.

With good policies Nepal may thus be able to combine economic growth with poverty reduction as in the Indian states of Kerala, Punjab and Hararyana. Nepal may learn from Kerala when it comes to investment in primary education and health, while it can learn from Punjab when it comes to investments in agriculture. Also in the case of rural and agricultural development the emphasize should be on public goods and market imperfections, as recommended by the recent world development report by the World Bank (2007). They focus on access to assets, by way of functioning land rental markets, mild land reforms, and education. Furthermore they emphasize technological innovations and diffusion, access to credit, as well as safety nets in form of guaranteed employment programs, and/or transfer programs.

If Nepal is able to follow in the steps of Kerala and Punjab, then we may expect an economic development of different sectors along the same lines. We have good data available from Punjab, which, in particular for terai, may be an ideal for further development within

Nepal. The Government of Punjab (2004) reports (in their Tables 9 and 10) the composition of the net state domestic product (NSDP), see our Table 10. Even though agriculture has been very important for the development of Punjab, the share in NSDP has declined from 54% in the 60s and 70s via 48% in the 80s and 90s, to 42% in year 2000. At the same time the composition of the agricultural product has changed with livestock becoming more important. Furthermore, the main service industry of trade, hotels and restaurant has increased from 10% to 14%, while manufacturing has doubled from 7% in 1960 to 15% in year 2000.

Table 10. Composition of net state domestic product, Punjab, in %

Sector	1960	1970	1980	1990	2000
Agriculture	54	54	48	48	42
i) Agriculture proper	43	39	32	31	28
ii) Livestock	11	16	16	17	14
Construction	10	9	6	4	5
Trade Hotels & restaurants	10	11	15	11	14
Finance, real estate	9	7	7	8	9
Manufacturing registered	3	4	6	9	10
Manufacturing unregistered	4	4	5	7	5
Within Manufacturing:					
i) Food, beverages, tobacco			24	21	20
ii) Cotton textile			7	9	9
iii) Woolen, silk synthetic			16	9	10
iv) Chemicals			8	14	12
v) Basic metals			11	13	11
vi) Metal products			13	8	10
vii) Transport equipment			10	10	11

Reproduced from Tables 9, 10 and 20 in Government of Punjab (2004).

Within manufacturing the industry shares have been relatively constant. But the employment share (not reported here) of food and beverage industries has doubled, while the employment shares of other industries have declined. The difference between output and employment shares reflects an underlying trend of increased investments that maintain the output shares of the capital-intensive industries, while the employment shares of those industries decline. At the same time agriculture has become more efficient. Table 11 in the Government of Punjab (2004) report shows that the yields of wheat have doubled from 2290 kg/hectare in 1970 to 4530 in year 2000, while the yields of rice have nearly doubled from 1940 kg/hectare in year 1970 to 3340 in year 2000. We conclude that Punjab has seen a normal development process with a gradual shift from agriculture to manufacturing and services, which is the result of improved efficiency in agriculture, and investments in manufacturing. Table 11 gives similar data for Nepal.

Table 11. Composition of gross domestic product, Nepal, in %

Sector	1970	1980	1990	2000
Agriculture	68	61	48	38
Manufacturing	2	4	7	9
Construction	2	8	10	10
Trade, restaurant, hotel	4	4	11	11
Transport, communication	3	7	6	8
Finance, real estate	10	8	9	11

Calculated from GDP-historical series, downloaded from www.cbs.gov.np.

We note that in contrast to Punjab, agriculture has declined more in Nepal. This reflects that Punjab was relatively developed already in 1960, and started out with a lower agricultural share in 1960 than Nepal had in 1970. But we note that agriculture in Punjab has continued to be important despite the development of the non-agricultural sectors. All incomes, including in agriculture, are higher than in Nepal, which is illustrated by the fact that agricultural workers from the eastern terai of Nepal go to Punjab for seasonal work in the agricultural sector. Among other industries we note the increased importance of construction in Nepal, while this has decreased in Punjab, and the still relatively small manufacturing sector in Nepal.

A successful growth process in Nepal, where the terai most likely will be the center of development, will probably imply a relatively stable GDP-share for the agricultural sector, which requires productivity growth and increased importance of livestock and other high valued products, as well as an increased importance of the manufacturing sector, and a corresponding decline in the relative importance of the construction sector. This means that some of the poor will gradually move from brick industries into regular factory work, while others will still work in the (increasingly productive) agricultural sector. For both sectors, the developments this far in Nepal, as well as in Punjab, indicate that these changes will reduce poverty. With such a development in terai, we shall expect continued migration from the hills, which may slow down the increase in incomes for the poor, due to the increase in labor supply in the terai. Continued labor migration to other countries may, on the other hand, counteract this effect. Note that an increased importance of the manufacturing sector in the terai will, at least in the short run, not imply urbanization in the traditional sense. Most factory workers in the terai still live in villages in traditional huts, with their main investment being the bicycle they use for transportation to work. The wages are still relatively low, in the range of 100 (1.5 USD) rupees per day.

There are indications from the field that also the excluded castes and ethnic groups take part in these developments. Landless terai Dalits of eastern Nepal now get jobs in

factories near Biratnagar, and they go to India for work, which have contributed to higher incomes, although not yet to improved social indicators. We believe the social indicators will improve in the future as these groups are able to accumulated income. Within the agricultural sector we may also expect that the landless, as promised by some political parties, will get a small plot of land, which will represent a safety net, as they can produce food for own consumption, and thus have a stronger bargaining position towards the landlords⁴. Land redistribution will be beneficial for the landless people in the remote parts of terai, while the Dalits and low-status ethnic groups near the cities will probably be better off working in factories. In the long run we shall expect these groups to get higher education which will allow for even better employment in other sectors in the future.

5. Possible new pathways out of poverty

In the previous section we discussed the normal pathways out of poverty in a growing economy, based on developments in Nepal during the last decade, as well as developments in India, where we used Punjab as an example. In this section we will discuss specific sectors that may appear as promising employment generators within Nepal.

The official debate on economic and social politics in Nepal focuses on the periodic development plans of the National Planning Commission. The Three Year Interim Plan is recently released, and is a follow up on the tenth plan, which is the present PRSP for Nepal. We find it useful to go back to the ninth plan, as it is more specific in its sectoral priorities. The ninth plan is reviewed in the tenth plan, and on page 10 of the PRSP (2003) we find the priorities of the ninth plan. For the agricultural sector the ninth plan recommended the use of irrigation, modern inputs, research, and extension services to increase crop production in the terai, as well as livestock and other high value-products in the hills. For the non-agricultural sector it focused on tourism, labor-intensive manufacturing, and hydropower. The priorities of the tenth-plan are more general, with broad based growth being the first priority. This reflects a gradual change towards general policy instruments to promote growth, in combination with targeted programs in the social sectors to promote human development, poverty reduction, and social inclusion. Although these targets are general, the interim plan also mentions tourism, hydropower and irrigation as specific priority areas, see page 29 of the Three Year Interim Plan (2007). Thus, infrastructure investments to support high value agricultural products, and development of hydropower and tourism are still priority sectors. In this section

⁴ See Hatlebakk (2006) for a discussion of land reform policies based on the Kamaiya experience.

of the report we will discuss whether it is a wise policy to give priority to specific sectors, and discuss to what extent they may benefit the poor and excluded.

Electricity, gas and water constitute 2.4% of GDP in 2004, while the trade, restaurant and hotel sector constitutes 9.8%, according to CBS (2005). Now the size of the tourism sector is hard to estimate, CBS (2005) reports foreign exchange earnings of 179 million USD in 2004, approximately one-fourth of the trade, restaurant and hotel sector. Relatively small sectors obviously have a growth potential. But even with a doubling of the number of tourists, which in 2004 was 385 000, the sector will still be relatively small. Tourism will thus be an important industry for some areas of Nepal, such as the Everest region, Annapurna, and parts of Pokhara and Kathmandu. Potential growth areas can be parts of terai, such as the Lumbini-Chitwan corridor, and parts of the hills, for example Kanchenjunga and Humla. In these tourist areas the poor may benefit directly as porters, or, even better, as lodge owners, or indirectly by producing vegetables and other goods for the tourists.

Small and large scale hydropower plants will be a major priority according to the Three year Interim Plan (2007). In particular the large scale projects will require domestic as well as foreign private investments, while the smaller, and possibly also the larger, scale projects might be subsidized by foreign aid. However, it is not clear to this author why the hydropower sector should be subsidized. Either the sector is profitable, and subsidies are not necessary, or the costs of developing the hydro power sector in Nepal are too high to make it profitable. Private investors are in the best position to make these decisions. The role of the government should be to allocate rights to build plants and transmission lines, taking into account public costs and benefits, including environmental costs, and positive externalities such as improved infrastructure. The poverty effect of investments in hydropower is far from clear. During construction of roads and power plants local people may get jobs. This effect will of course be smaller the more work is done by labor migrants from India, or elsewhere. After the construction period, the poor may benefit from the use of electricity, and in principle, the population of Nepal may benefit from the incomes. However, this requires de facto positive profits, as well as a good taxation scheme.

Among the sectors mentioned in the development plans we believe that for the rural poor a focus on high value agricultural products is a good long term strategy. These products will develop as people can afford higher quality food. Increased demand for milk and meat products will lead to more livestock, and increased demand for vegetables will give a more intensive form of farming. In the short run, there may be excess capacity in the sector, and thus not very high profits, but as demand increases we shall expect increasing incomes.

Vegetable and livestock production is in particular suitable for the poor, as they tend to have small farms and sufficient labor for intensive production on smaller plots. Furthermore, the initial investment can be relatively small, and can be gradually increased from a few chickens, to goats, to cows, to more land. Investment in livestock is also popular within micro credit programs, so the initial investment can be relatively easy to finance. The role of the government and donors in this growth industry for the poor must first of all be in research and extension services. For some products there is a tendency for concentration, in particular for new products that are knowledge-intensive in production and marketing, such as tea, coffee, and cardamom. In particular for these products, the government may play a role in training small farmers in both production technologies and in marketing strategies. As these particular markets are not local there may also be a role for international NGOs in organizing marketing cooperatives.

More recently there has been a focus on mobile phones, which obviously can be used for sharing information, for example on market prices, but also for mobile banking, see DFID (2008). This DFID report on inclusive growth also focuses on tourism, hydropower and labor migration. We have already discussed these other industries. When it comes to mobile phones, this author does not believe that the government, or the donors, need to participate. The private sector has developed the mobile phone industry in Nepal to an extent where most households now have easy access. Private banks are also gradually expanding their services to the rural sector. Most households now have access to private banks in a market area relatively close to their village. However, there may still be a role to play for credit programs that can raise loans for the poor.

DFID (2008) recommends specifically subsidized loans for migrants. As we discussed in a previous section labor migration has been a way out of poverty for many people, and in particular we know that the poor go to India for work, which is not very costly. However, we do not, yet, know why the poor do not go, for example, to the Middle-East to the same extent. This might be due to lack of money, which is what they say themselves in interviews we have conducted. But the real explanation can still be that the employees of manpower agencies do not trust the very poor and low-caste people. There can be many reasons for this, including prejudices. Some formal education is needed to work abroad, and the agencies may in addition believe that the migrants should be used to the urban and modern life that they to some extent will have to live in the Middle-East. The manpower agencies will also need to know that potential migrants are able to raise the credit, and some people may be in a catch-22 situation where they do not get selected by the manpower agencies because they cannot

raise the credit, and they cannot raise the credit without papers from an agency. Migration-loans may appear to be a way out of this trap, but this is far from sure. Based on our fieldwork, where we have interviewed manpower agents and migrants, it appears that the agencies use the fact that you are able to raise credit with neighbors in the village as a signal that you are a "good" person that will work hard to repay the loans. A credit program will not necessarily be able to replace this function. We thus believe that more sophisticated measures are needed to get poor people to migrate to the Middle-East and other attractive destinations.

Again we believe that international NGOs may play a role by establishing niches in the migration market. NGOs may recruit and raise loans for people from excluded groups, such as the terai Dalits, who want to work in the Middle East. These NGOs must be able to convince employers that they can get maybe even better workers if they select people who are used to manual work from home. Today there are many migrants from Nepal that are doing work abroad that they would never do at home, and as a consequence they do not have the experience that low caste people may have. Ideally the private market should also benefit from this opportunity, but prejudices may still be a barrier. In addition, the Dalits may need extra training before they leave as the educational level is on average lower. The government and the donors may support NGOs that want to do work in this field, including local Dalit organizations.

In general it is hard to identify new and promising businesses that also will benefit the poor. We believe the potential is best within industries that are likely to grow based on experiences from other countries, and where entry barriers are low. High value agricultural production for local consumption is one such industry, as discussed above. Some service sectors are also obvious candidates. We believe, for example, that training programs for poor and excluded people within different semi-skilled trades will have a good effect on poverty reduction and social inclusion, and may also make people more attractive for the manpower agencies that recruit migrants. Attractive skills may be as masons, tailors, mechanics, and drivers. Again we believe that local Dalit NGOs may play an important role in collaboration with international NGOs.

6. Conclusions on policies for inclusive growth

Inclusive growth requires, by definition, both economic growth and inclusion. Thus a policy for inclusive growth will have to combine traditional policies for economic growth with policies for inclusion. In some cases there are no conflict, while in other cases there will be a

trade-off between economic growth and inclusion. *Education and training programs* are both growth enhancing and inclusive, if they are targeted towards the poor and excluded. The government, donors and NGOs will play an important role in targeting the poor and excluded, both when it comes to primary education, as well as skill training programs. For primary education it is important to identify simple measures that can keep in particular Madhesi Dalit children in school, as this group still has a literacy rate below 10%. We believe that school lunch will be an efficient, and inexpensive, measure. Local Dalit leaders may play an important role in recruitment and organization of literacy and training programs within their own communities.

Access to inexpensive, and good quality, *health services* are also important for both economic growth and human development. Medical crisis are for most poor people the major uncertainty they meet in life, and it is today very hard to insure against these costs in Nepal. This is in particular so for major health problems where hospitalization is needed. People to some extent insure against these risks by helping others with medical expenses. By proving that you support these informal insurance mechanisms you are also insured yourself to some extent. But, this, in turn, implies that you sometimes have to give "your own people" benefits that are not always economically beneficial. A subsidized health service, in particular for major health problems, is probably the most efficient way to insure people against these risks. Here international donors may play a major role in supporting for example regional hospitals.

Physical infrastructure is necessary for economic growth. For a small country like Nepal it appears that connections with neighboring countries should be of highest priority, in particular electricity transmission lines, as well as easy road and train access to the sea. A new highway access to Kathmandu must be part of these investments.

Investments in physical and human capital will require funding. Donors may contribute, but it is also important to establish a good *broad-based domestic tax system*, where most economic sectors must contribute. And with the new federal system coming up, it is important to redistribute incomes from the very few districts (around Kathmandu, and the central terai region) with extensive economic activities to the majority of districts that still lack major income sources.

In addition to a subsidized health service, different types of social security nets will be beneficial. A good security net will target people who otherwise are not able to participate in normal economic activities, whether it is due to caste-based discrimination, or disabilities. One will have the choice between general programs, like old-age pensions, and targeted programs, like the land-redistribution program for the ex-Kamaiyas. General programs are

costly as economically productive people may get incentives not to work so hard, and even rich countries are now rolling back some of the most expensive general social-security programs. Targeted programs are, in fact, hard to target as the needy are not always easy to identify. However, in the Nepali context it may be easier than elsewhere, as specific castes and ethnic groups are discriminated against socially and economically.

Among the targeted programs that have been discussed and implemented in Nepal are the Land bank, land redistribution to the landless, land titlement for occupied government land, and employment guarantee schemes. We believe that land titlement and redistribution programs are useful, and should follow the success of the Kamaiya program. Landless Dalits, who mostly live in the eastern terai, should get access to a small plot of land, for example 5 kattha of land as in the Kamaiya case. This will allow them to produce vegetables and cereals for own use. This will provide them with a basic security net, and thus an improved bargaining position in the local labor market, as discussed by Hatlebakk (2006 and 2007). For people who want more land we believe that the Land bank is a good program. Under this type of program the landless, or marginal farmers, can take loans to purchase land, using the purchased land as collateral.

The employment guarantee scheme of India is much discussed. Basu (2008) is critical due to the costs, in particular the inefficiencies of tying up labor to relatively in-productive activities. Other economists are more positive, including some of Basu's colleagues at Cornell, as they focus on the fact that the guarantee is only for 100 days of work per household, which can be easily implemented during the lean season, see Basu, Chau and Kanbur (2008). We are, this far, convinced by the latter argument and believe that the employment guarantee may preferably be implemented in Nepal, maybe starting in remote parts of eastern terai where there are still many landless Dalits that are discriminated in the labor market.

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