SM/84/117
Correction 1

CONTAINS CONFIDENTIAL
INFORMATION

June 25, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Nepal - Staff Report for the 1984 Article IV Consultation

The following correction has been made in SM/84/117 (5/23/84):

Page 15, lines 1-4: Delete "Nevertheless, the Government...and food prices."

A corrected page is attached.

Att: (1)

Other Distribution:
Department Heads

is unlikely to be excessive. In examining the trade-offs, it is important that the authorities also consider the overall resource strains and the inflationary pressures that can emerge as subsidies compete with development projects for scarce resources.

Credit is provided to small farmers by the Agricultural Development Bank (ADBN) through its Small Farmers Development Program, and by commercial banks under the Intensive Banking Program. Consideration is being given to allowing the ADBN to compete for deposits with commercial banks in urban areas for commitment to this program. The experience with this credit allocation scheme up to now suggests that a more active role in deposit taking and credit allocation by the ADBN may serve over time to improve the credit flow to the rural sector. The banks, whose major operations consist of commercial lending to a relatively few large firms, are to commit the equivalent of 10 percent of their deposits to loans for agriculture, cottage industry, and priority service sectors at subsidized interest rates. As of November 1983, priority sector credit from commercial banks was equivalent to only 3.5 percent of deposits; about one half (NRs 113 million) of such credit had gone to agriculture.

A major effort has been made to raise agricultural productivity by increasing irrigation facilities. Land area under irrigation has risen by about 25 percent over the past four years, but nevertheless only 15 percent of the cultivable land is currently under irrigation. Moreover, the current utilization rate is estimated at less than 50 percent. In 1983/84, the Government launched an extensive program to provide 3,000 shallow tube wells to growers during the year, with the Government absorbing about one third of the cost.

An important element in improving agricultural productivity is the adequacy of pricing policy and buffer stock facilities. Frequently, support prices are announced only after planting and then set at levels below market prices, without providing adequate financial incentives to increase production. The authorities indicated that they would like to announce minimum support prices earlier so as to encourage production, but there are serious constraints, such as the lack of storage facilities and the difficulty in predicting Indian support prices. The support price for paddy was raised by 27 percent in July 1983, and that for raw jute, by 86 percent in February 1984. To facilitate implementation of the support price scheme, the Government intends to expand the storage capacity of the National Food Corporation (NFC) from the present 54,000 tons to 100,000 tons by end-1984/85. The targeted volume of foodgrain procurement for 1983/84 is 38,000 tons and, in addition, 10,000 tons is to be procured under the food security (buffer stock) program under which stocks are to be increased to 20,000 tons by the end of 1984/85. Rice from NFC stocks is sold at uniform, subsidized prices throughout the country. Since this rice is of low quality, the authorities did not believe that the subsidized rice sales were discouraging foodgrain production by depressing producer prices for standard quality rice.

The main thrust of the Government's industrial policy is set forth in the Industrial Enterprises Act and Foreign Investment and Technology Act. The Acts aim at encouraging the development of export-oriented cottage industries, as well as import-substituting industries, mainly through provision of tax incentives and credit facilities. The basic objective has been to develop 30 industries, mainly in the private sector, including textile mills and spinning mills, a cement factory, sugar mills, a dry cell battery plant, dairy products, metal works, carpet making, handicrafts and leather manufactures. To implement these Acts effectively, the authorities intend to strengthen their administrative capacity in general. In particular, adequate coordination between the Ministry of Industry, which is responsible for implementation of industrial policies, and the Ministry of Commerce, which issues import licenses, will be required to ensure adequate supplies of raw materials and intermediate goods. Shortages of inputs are reported to have constrained production in some of the industries concerned.

2. <u>Demand management policies</u>

a. <u>Fiscal policy</u>

Following the deterioration in demand management policies in the previous two years, which was particularly serious in 1982/83, the Government's revised budget for 1983/84 reflected a strong commitment to the pursuit of economic stabilization as the foundation for sustainable growth. With respect to revenue, the strong increase in 1983/84 (Table 2 and Chart 2) reflects buoyant economic activity, but also the impact of new revenue measures and improvements in revenue administration. Revenue measures announced in 1982/83 which came into effect in 1983/84 include increases in income taxes in the higher brackets and increases in automobile registration and user fees. The 1983/84 budget introduced further revenue measures, such as an import license fee ranging from 5 to 25 percent on imports from countries other than India and increases in sales taxes on unfinished goods. The increase in nontax revenue of about 50 percent reflects not only the additional fees and charges, but also a notable increase in operating surpluses of some public enterprises.

The growth rate of expenditure has been cut sharply this year, with a particularly steep decline in the growth of development expenditure. In part this is due to special one-time, drought-related expenditures in 1982/83 but, in addition reflects the Government's concern about its overall budget deficit. The slower growth of current expenditure in 1983/84 also reflects, inter alia, the Government's decision not to grant a wage increase to civil servants this year. Budgeted development expenditure was reduced by almost 20 percent in the revised budget, many