Dutch disease starts to take toll on economy

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KATHMANDU: The country seems to have started showing the Dutch syndrome due to the rise in huge inflow of remittance — that has swelled not only the foreign currency reserve but also the Balance of Payment — and the fall in the manufacturing sector's contribution to the economy, coupled with ballooning trade deficit and real exchange rate appreciation.

"High remittance inflow into the country has led to the emergence of Dutch disease effect and fostered policy complacency among policymakers, particularly on the need to formulate and implement reforms that would improve investment climate, increase job opportunities domestically, and channel remittance to productive sectors," according to senior economist Prof Dr Bishwhambher Pyakuryal.

The current structural changes in the economy revealed by the Central Bureau of Statistics data needs to be taken seriously and should start addressing policy laxity in improving weaknesses and facilitating a sound investment climate by trade facilitation that could result in boosting of the shrinking manufacturing and exports sector," he said, adding that the biggest loser has been the tradable sector, agriculture — that has 33 per cent contribution to the GDP — and manufacturing sectors, which have seen a steady decline in production as a share of GDP."

He cautioned that high inflow of remittance should not be considered as a substitute to formulating and implementing growth and job-creating investment policy reforms. "Productivity should be increased in both tradable and non-tradable sectors, but if the country continues to experience real exchange rate appreciation, then spending should be diverted to sectors that boost productive capacities of non-tradable and non-resource tradable sectors," the senior economist added.

Due to lack of job opportunities — push factor — back at home due to incumbent government's inefficiency that has led to deindustralisation in the country and higher pay overseas — pull factor — Nepalis especially unskilled, low and medium skilled workforce have been emigrating since the last one decade. During fiscal year 2011-12, a total of 530,805 Nepalis migrated in search of greener pastures to the Gulf and Malaysia due to the economic boom in the Middle East that led to an increase in demand for workers.

The massive outflow of migrant workers also helped increase the inflow of remittance to over three-and-a-half times to Rs 320.37 billion — in the first 11 months of the last fiscal year — from Rs 100.14 billion in fiscal year 2006-07. The Central Bureau of Statistics revealed that only 2.4 per cent of the remittance is spent on capital formation leading to more consumption-led imports.

"Remittance has financed imports, leading to an unsustainably high merchandise trade deficit, which has reached as high as 26 per cent of GDP," another trade researcher Chandan Sapkota, said, adding that the remittance-financed high imports have also been crucial for revenue generation as over 50 per cent of total tax revenue is coming from consumption tax. The country's import has increased by four times to Rs 419.57 billion — in the first 11 months of the last fiscal year — from Rs 125.5 billion in the fiscal year 2002-03.

However, the export has increased to Rs 67.21 billion — in the first 11 months of the last fiscal year — from Rs 49.2 billion in a decade, according to central bank data. "Whereas the export had recorded Rs 67.70 billion in 2008-09, which has seen a decline in the last three fiscal years."

According to the household survey 2010-11, about 56 per cent of households received remittance, both from internal as well as external sources.

From 2000-01, when remittance started increasing dramatically, merchandise export as a share of GDP also started to consistently decline widening the trade deficit gap, he said, adding that reforming the domestic investment climate is key to entice private sector investment with an objective to spur growth and employment opportunities that will provide a safe landing to the overdependence on remittance and dissociation from its negative impact.

Though remittance has been crucial in reducing poverty and inequality in the last one decade as it has boosted expenditure capacities of poor households and widened their consumption basket, it has also boosted foreign exchange reserves, largely contributed to keeping balance of payments in surplus, and increased gross national savings.

But remittance has also been responsible for the Dutch disease effect, which is the loss of competitiveness of non-resource tradable sector —

exports sector — due to the appreciation of the exchange rate after substantial inflow of resources from one particular sector —– remittance, according to Sapkota.

“The rising remittance inflow has allowed the government to ignore many pressing policy decisions and assume that everything is normal,” according to former finance minister Dr Prakash Chandra Lohani. “The feeling of normality allows politicians in the country to continue their games of political brinkmanship and the never ending discussion on the promulgation of a new constitution,” he said, adding that logically we should have used this ‘time cushion’ provided by the inflow of remittance to build the productive capacity of the economy so that we are able to compete in the tradable sectors and in areas where we claim to have competitive advantage. “The caretaker prime minister Dr Baburam Bhattarai’s date expired pills cannot help recover the economy.”

What is Dutch disease

KATHMANDU: In economics, the Dutch disease is a concept that explains the apparent relationship between the increase in exploitation of natural resources and a decline in the manufacturing sector. The mechanism is that an increase in revenues from natural resources — or by any economic change that provides a large increase in the availability of foreign exchange to the economy, a sharp increase in export prices, foreign direct investment or inflows of foreign aid — will make a nation’s currency stronger as compared to that of other nations — manifest in an exchange rate — resulting in the nation’s other exports becoming more expensive for other countries to buy, making the manufacturing sector less competitive. While it most often refers

to natural resource discovery, it can also refer to ‘any development that results in a large inflow of foreign currency, including a sharp surge in natural resource prices, foreign assistance, and foreign direct investment’. The term was coined in 1977 by The Economist to describe the decline of manufacturing sector in the Netherlands after the discovery of a large natural gas field in 1959. — Wikipedia