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A note on

Prospects for Currency Devaluation in Nepal

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Devaluation as a tool, is resorted to by a Country, to overcome the balance of payments difficulty. The main object of devaluing home currency vis–a–vis currency of an another country with which it has balance of trade deficit, is to make home good cheaper, and thereby raise exports. Such a measure to become successful, needs some essential preconditions to be fulfilled. Firstly, the exported items of a country devaluing her currency should be important items of use in another country which is importing them. Secondly, some of these exported items should be in short–supply in a country to which these are exporting.

Since Nepal's accumulated trade deficit has touched a high figure of as much as 3 billion rupees only recently; devaluation as a tool of curing the present ills warrants looking into from standpoints more than one.

The total population of Nepal according to 1971 population census, is around 11.85 million. The rate of population growth in the country is 2.2 percent per annum. Of the total 11.85 million people, nearly 4.9 million people or 41. percent one representing the labour force. Of this, 4.6 million people or 94.4 percent are occupied with farm activities., 0.5 million people or 1.1 percent with manufacturing, 0.6 million people or 1.4 percent with trade & commerce and 1.4 million people or 2.8 percent with services and so on. The GDP[1] (Provisional) for the entire country in 1975/76 is 14802 million rupees. Of this, agriculture sector represents 9949 million rupees or 67 percent, industry, 463 millon rupees or 3 percent of the total. The trends of GDP

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1. Agriculture Statistics of Nepal, 1977, HMG, Ministry of Food, Agriculture & Irrigation, DepH. of FAMs Agr. Stat. Div, Kathmandu, NOV. 1977, Table 1–1, P. 7.

in agriculture at current prices indicated a growth rate of 1.9 percent per annum. The non-agriculture sector on an average has indicated a growth rate of well over 10 percent per annum. Paddy, Maize, wheat, Millet among food crops and Jute, Sugar, tea and Oil seeds among cash crops are important items of agriculture production. We import many items ranging from toys to Aeroplane from third countries. Of the total imports[2] of Nepal of 1982 million rupees in 1975/76, India's share represents 1287 million rupees or 61.8 percent of the total. Industrially, over 80 percent units are of Food[3] processing category. The gross output and the value added of industrial sector ammounted to 1758 million rupees and 326 million rupees in the year 1972/73. Imports as a percentage of total national markets for manufacture[4] constitute approx. 47 percent of the total. Of the total exports of 1186 million rupees in 1975/76, India represents 894 million rupees or 77.9 percent of the total. Of the total goods exported to India, foodstuffs comprises nearly 82 percent of the total during the same year.

In view of above, slow growth rate in agriculture, of backward industrial sector, and of high components of foodstuffs in our exports, dexaluation as a correcting device to bridge the ever rising trade deficit with India and its possible consequences upon the economy may be timely.

Apparantly, there are two possible ways by which our trade deficit with India can overcome (i) Expanding our foodstuffs exports and (ii) Reducing customs duty on foreign goods mostly purchased by Indian customers (since a large proportion of these goods imported from overseas countries find on route to Indian market, finally), Neither of these two possibilities seem to succeed under the existing circumstances for two main reasons. Firstly, expansion of foodstuffs exports to India is not likely to be achieved, atleast in the present situation when she is holding a foodgrain surplus of 19.5 million tons[5]. Even in case of dificiency of foodgrins in India, devaluation as a policy of correcting balance of trade deficit has got limited application in Nepal for two important reasons. In the first place, agriculture is highly dependent on monsoon and rainfall and its supply cannot be increased in the short run due to price inelasticity. In the second place, chances of increasing foodgrains export to India are marred by the

2. Quarterly Econ Bulletin, Nepal Rastra Bank, Vol XIII, Mid-April 1979, No. 3, PP. 50-51.

3. Census of Manuf. Est. 1972/73, Central Bureau of Statistics, Kath. 1975,

4 D. B. Amatya, "Ind. Dev. in Nepal 1937--1973," (Forthcoming)

5. The Statesman, Feb. II, 1980.

recent shortages of such goods seen in Nepal. Contrary to expectation, India has agreed to provide Nepal with 25 thousand tons foodgrains to oxercome her deficits.

Secondly, an incrase in re-exports to India of foreign goods is hardly possible in the face of the Prime Minister Mrs. Gandhi's likely severe stance against traders and smmuglers of foreign goods in that country.

In view of the limitations pointed out above, devaluation if resorted to, is likely to bring about consequences like further windening of trade deficit gap with India due to limited exportable items in the country, and a fall in the standárd of living of the masses as a consequence of mounting prices of daily necessities, a large part of which is met by importing goods from India.

In my opinion, the only alternative solutions are the imposition of quota, restriction on Indian curreucy and the reduction in the imports bills of Nepal. While the former involves imposition of a tighter regulatory measure in respect of Indian currency's buying and selling activities which would then allow imports of only necessary goods ultimately leading to narrowing of further trade deficit, whereas the later calls for encouraging home producer to establish consumer goods industries by providing appropriate facilities, which in turn would lead to or a fall iu imports of such goods with a rise in the share of manufactured goods in exports of the country in course of time. Until then, HMG of Nepal may seek the postponement of payment due to India from the Govt. of India, which considered the good neighbourly relations existing with that country, may not be a much too deficult a task to accomplish.

Book Review

Kumar Kanta Jha, Agricultural Financc in Nepal: An Analytical Study

New Delhi : Heritage Publishers, 1978 Pages XVI+241, Index. Price : Rs. 50/- (I C.)

Agriculture dominates the economy of Nepal by all measures: share of GDP, employment, exports, etc. Stagnation in the agricultural sector has been reflected in very low growth rates in real GDP and GDP per capita. Long term recovery from this stagnation in the form of steady advances in agricultural output per capita will undoubtedly require technological change and capital accumulation in farming, which in turn necessitate mobilization of funds for investment on a scale which has not yet been approached in Nepal. By presenting a careful analysis of agricultural finance in Nepal, Dr. Jha has made a major contribution to the understanding of the problem of capital formation in agriculture and hence of the problem of agricultural development and economic growth in Nepal.

Agricultural Finance in Nepal is the study of the demand for and supply of funds for investments based on a survey of 142 farmers in six villages of the Eastern Terai. Dr. Jha has accumulated and analyzed extensive data on levels of borrowing, rates of interest, purposes of borrowing, collateral, types of lenders, and net accumulation of assets for farmers classified by size of cultivated land holdings. The careful reader comes away with a detailed knowledge of the problems of agricultural finance in the six villages, and, with the usual leap faith necessary in survey studies, for Nepal as a whole.

Summary of Contents

The study begins with a survey of the general state of agriculture in Nepal and its role in the economy. The usual bleak picture in painted: a country with only 13.67% of its land under cultivation and an equal percentage potencially reclaimable; a rapidly growing population which already implies a per capita availability of arable land (.214 hectares per person) lower than that of Burma or India; a low use of fertilizer, irrigation (only 6% of cultivated land) and improved seeds (only 5.58% of cultivated land) resulting in yields per acre which are well below those reached in developed countries and which have shown virtually no growth over

the twenty years period preceeding 1970; a system of land tenure characterized by small holdings and widespread tenant farming.

"Anatomy of Credit" presents extensive data in the analysis of loan characteristics and draws several interesting and significant implications. Farmers are divided into four groups according to size of cultivated holdinigs. While the proportions of families borrowing are roughly constant accross the four groups, the size of borrowinges per family is directly related to size of holdings. Another common feature across the groups is the high percentage of loans for family expenditure purposes- 71.43% of the value of loans for all families. An average of only 19.46% of the value of all loans is for current or capital expenditures on the farm. The distribution of rates of interest (Table 3.12) indicates that over 95% of all loans carry interest rates below 30%, and the bulk of loans (54.78%) have rates between 21 and 30 percent. Interest rates appear to vary according to loan purpose with capital expenditures carrying low rates and family purchases the highest rates.

This discussion is followed by analysis of the stock of debt, the changing asset positions of the farmers, and the sources of finance. Debt as a proportion of repayment capability, measured in a variety of ways, shows the relative burden of debt rises with the decline in cultivated holdings. Over 90% of all debt matures within one year, a fact which discourages capital investments with long payoff periods. Considering investment and disinvestment in all areas, there is very little net investment by farmers, and "non-agricultural assets have absorbed the lion's share of total investment among every class of cultivators" (p.122).

This discussion followed by analysis of the stock of debt the changing asset positions of the farmers and sources of loans. Eighty-six percent of all funds come from traditional money lenders and only seven and one half percent are from banks and co-operatives. Official institutions as sources of capital-cooperative societies, the Agricultural Development Bank (ADB), and the compulsory savings scheme- are also studied, followed by a concluding chapter with several recommendations for policy.

This brief survey of the book's contents indicates the breadth of subject matter related or agricultural finance in Nepal which is covered by Dr.Jha. The problems inherent in this most crucial aspect of agricultural development are carefully surveyed and analyzed.

Evaluation and Critique

My critical comments are quite mild in comparison with my overall reaction to Dr. Jha's treatise. As a survey of the problems of agricultural finance, there is little to find fault with. It is in the area of broader implications and policy recommendations that most of my comments are directed.

A number of minor points on the use and presentation of the data must first be discussed. First of all, the book offers an abundance of data, which is presented exclusively in tabular form. With the wealth of information provided it is difficult for the reader to keep track of all that is being presented. Usually an entire table could be replaced by or supplemented with an analysis of variance, which would not only summarize the information concisely but would also distinguish between statistically significant and insignificant differences, this would add to one's confidence concerning Dr. Jha's conclusions.

In this vein apparent differences between the farmer groups may be overstated. One of the most important of these exaggerations is in the differences in interest rate paid by the four groups of farmers. Table 3.11 on page 43 shows the AVERAGE rate of interest declines with size of cultivated holding. But how meaningful are these average interest rates ? When table 3.12, showing the complete distribution of loans by interest rate, is examined, it is difficult to see that the "average" interest rate of 33.4% for small farmers has any meaning at all. Eight percent of all loans to small farmers carry an interest rate which is less than 31%. The overall distribution–not just the average–suggests a great deal of similarity in the rate structure charged to the four classes, contrary to the assertions in the text.

These statistical issues have some bearing on the general tone of Dr. Jha's analysis and specific conclusions. The "high" interest rates and disadvantaged position of the small cultivator feature prominently in the critique of the money lender as well as in the discussion of the overall problems of agricultural investment. While the legal status of the money lender and the risks inherent in agricultural loans are recognized as significant costs to money lenders, and the importance of the money lender as a source of funds is conceded, there is a negative attitude towards the money lender which does not rest on any analytical foundation.

The money lender is often criticized for extending loans for profit regardless of purpose (p. 137), so that funds are directed to unproductive purpose. This is obviously a criticism which should be leveled at the farmers who decide on their borrowing needs. The lower interest rates charged for "productive" loans (pp 46–48) indicates a preference for capital expenditure and current farm expenditure loans by the lenders.

An examination of the distribution of interest rates in the context of an agricultural economy characterized by high risk, specialized security, and inflation suggests the rates charged by money lenders may not be unreasonable. It should be noted, first of all, that interest rates are considerably higher for family expenditure loans, which carry little security, than for capital and current farm expenditures. Interest rates on these latter "productive" purpose loans averaged 16% (for capital expenditures) and 20.5% (for current farm expenses) as opposed to 27% for family expenditures. For an enterprise affected by the vagaries of drought and flood, the risks of crop damage from pests and the uncertainties of price fluctuations, interest rates of 16 or 20.5 percent cannot be considered unreasonable.

Dr. Jha recognizes that the traditional money lender does have a role to play in contemporary agricultural finance, and he argues that debt legislation which might inhibit the relation between farmer and money lender would cause considerable hardship for the farmer (pp,143-4). He also concludes that money lenders should be subject to some regulation (p.216) as they will remain an integral part of any subsistence agricultural economy. However, his policy recommendations, both with respect to money lenders and in other areas do not go to the heart of the problem of capital mobilization.

In this connection two lines of investigation are suggested to me by the information contained in Agricultural Finance. One is the construction of an analytical model of the supply and demand for agricultural investment funds, incorporating the factors cited (p.98-99) as reasons for low investment rates – high interest rates, surplus labour, risk, small scale of farming, and the system of land tenure. The construction and manipulation of such a model might suggest which of a number of alternative policies – crop insurances, price supports, control of interest rates, etc-could be most effective in raising the level of agricultural investment. The second line of research is to examine the effects of lending and borrowing by organized financial institutions (commercial banks, ADB, cooperative societies) at interest rates approaching

those charged by money lenders. The existence of money lenders indicates there is capital available for agricultural investments. The problem is to channel these funds into agriculture in a way which encourages productive expenditures. The main weakness of the money lender in performing this function is his insistance on short term loans, which is in conflict with the long gestation period of many agricultural projects. It is this conflict which organized financial intermediaries are suited to mitigate, by accepting short term deposits and offering longer term loans. However, the organized financial institution will not be successful in attracting sufficient funds as long as their lending rates and hence their interest rates paid on deposits are held artificially low. At sufficiently high rates of interest the funds of money lenders and similar sources of capital may be channeled through a financial intermediary to the cultivators at term (moderate interest costs, longer time to maturity which are conducive to productive agricultural investments.

Conclusion

Readers of Agricultural Finance in Nepal will be indebted to Dr. Jha for his thorough and careful presentation of a wealth of information on credit in agriculture, his analysis of a wide range of issues related to the problems of agricultural finance and his discussion of policy options in this area. This reader, in particular, found an informative and readeable analysis of issues in agricultural finance and insights into this major aspect of the economics of agricultural development.

–ROBERT McNOWN